5TH PROCUREMENT FRAUD COURSE DESKBOOK

SUMMARY OF CONTENTS

June, 2002

OUTLINE OF CIVIL FRAUD

I. Introduction

A. Authority to bring civil fraud action

only the Attorney General has authority to initiate, compromise, or close claims involving fraud against the United States

1. the Civil Division has authority over fraud claims where single damages and penalties are over $1,000,000

2. automatic delegation to U.S. Attorney's Office where single damages are less than $1,000,000. Cases may be handled above that amount on a supervised basis.

B. Administrative handling of fraud matters

1. Program Fraud Civil Remedies Act (31 USC § 3801)

   - allows agencies to administratively obtain damages for fraud
   - need permission of Department of Justice
   - can be used for fraud where damages are less than $150,000
   - up to double actual damages and forfeitures up to $5,000 per false claim
   - dispute decided by administrative law judge; review by district court
   - can subpoena records as part of investigation

2. administrative remedies for inflated Defense contract claims under Department of Defense Authorization Act of 1986 (10 USC § 2324)

3. Civil Monetary Penalties Law (42 USC § 1320a)

administrative remedies by Department of Health and Human Services for false Medicare and Medicaid claims - up to treble damages and up to $10,000 for each false service.

4. Contract Disputes Act (41 USC § 604)

- Contract Disputes Act governs disputes between contractor and contracting officer. Contracting officer is to decide all disputes. Contractor can then appeal ruling to a board of contract appeals or the U.S. Court of Federal Claims.

- Contract Disputes Act explicity states that contracting officer cannot rule on or compromise any claims where fraud is alleged. 41 USC § 605(a).

II. Civil Remedies

A. False Claims Act (31 USC § 3729-33)

Generally, the False Claims Act provides for damages against one who submits false claims to the Government, causes false claims to be submitted to the Government, or makes false statements to the Government.

1. who can be sued

- individuals
- corporations - liable for the acts of their employees
- partnerships

2. nature of a claim

Any claim for payment or transfer of Government funds or property, including:

a. invoices for payment on a contract
b. application for a loan
c. claims arising from loan guarantees

examples: false claim

1) invoice for inflated number of goods
2) uses substitute materials but submits invoice as if in compliance with contract
3) reverse false claim (§ 3729(a)(7)) statement to decrease payment to Government

false statement

1) defective pricing
2) false statement on loan application

causes false claim to be submitted

1) subcontractor on procurement
2) Medicare fraud
3) false application on guaranteed loan
4) collusive bidder

3. knowingly presents a false claim

a. has actual knowledge or
b. acts in deliberate ignorance of the truth or falsity or
c. acts in reckless disregard of the truth or falsity

no specific intent required

compare with criminal law requirement of mens rea

4. knowledge of the falsity by the Government

knowledge by Government officials may not defeat False Claims Act liability

5. statute of limitations

a. within 6 years of violation or
b. within 3 years of when we learned about violation but
c. never more than 10 years

6. damages

   a. formula - amount paid minus the value of that received.

   b. treble actual damages

      - if restitution made; first treble damages and then reduce by amount of restitution (come clean provision -notify U.S. within 30 days of learning of fraud; double damages plus our costs)
      - the law is uncertain as to whether we can obtain consequential damages under the False Claims Act. U.S. v. Aerodex, 469 F.2d 1003 (5th Cir. 1972) says we cannot, but states that we can recover consequential damages under breach of warranty or contract causes of action. Other cases indicate that we are entitled to our natural and proximate damages.

   c. civil penalty of $5,000-$10,000 for each false claim

      - where false invoices from subcontractor to prime contractor, count invoices from sub to prime, not prime to U.S. U.S. v. Bornstein, 423 U.S. 303 (1976)

      - amount of penalties may be limited by court pursuant to the Excessive Fines Clause

   Note: we can seek penalties even if there are no actual or provable damages

7. Types of cases

   a) items billed but not delivered
   b) product substitution
   c) product testing
   d) mischarging
   e) front loading progress payments
   f) bid rigging
   g) federal loans and insurance
   h) contract eligibility

i) defective pricing
   1) cost or pricing data
   2) discount and marketing data
      negotiated contracts for commercially available items
      certify to lowest prices available

8. Qui tam provisions - whistleblower suits

a) can't be based only on public knowledge obtained through Government hearing, investigation, or report unless relator is an original source

b) courts generally have ruled that Government employees can file qui tam suits; less clear whether investigators and auditors can file qui tam suits

c) relator files complaint under seal and provides complaint and written disclosure statement of facts to Attorney General and U.S. Attorney

d) we then have 60 days to investigate and make decision whether to intervene

e) we can seek extensions

f) if we intervene, we take charge

g) if we decline, relator continues suit

h) relator gets a percentage of any recovery

- 15-25% if we intervene
- 25-30% if we decline
- reduced percentage if relator was involved in the fraud

i) even if we decline, settlement requires our consent

B. Additional remedies and causes of action

1. common law fraud

a. elements

1) a material representation by defendant
2) the representation must be false
3) the representation must be made with knowledge of its falsity or with reckless disregard for its truth
4) the representation must be made with the intention that plaintiff act upon it
5) plaintiff has relied and has been damaged as a result

b. damages

single damages plus punitive damages and consequential damages

c. statute of limitations

three years from act complained of or three years from when official with responsibility to act knew or reasonably could have known of the right of action

2. breach of contract

a. elements

1) a contractual obligation
2) a failure to perform
3) damages resulting from that failure

b. damages

single damages plus consequential damages

c. statute of limitations

six years from the breach or six years from when an official with responsibility to act knew or reasonably could have known of the breach

3. unjust enrichment/payment under mistake of fact

these are equitable principles based upon the unfairness of having someone retain possession of money or property to which he is not entitled

damages and statute of limitations are the same as for breach of contract claims

4. bribery and conflict of interest

the United States may seek recovery for bribery and conflict of interest from both the payor and payee of the bribe. Suit against the payor is under a common law fraud theory. Suite against the payee is for breach of an implied contractual relationship under common law breach of contract. There is a rebuttable presumption that the United States was damaged in the amount of the bribe.

5. other common law damages

a. recovery of all amounts paid under contract - U.S. v. Mississippi Valley Generating Co., 364 U.S. 520 (1961); K&R Engineering Co. v. U.S., 616 F.2d 469 (Ct. Cl. 1980)

b. profits

c. recision of contract
U.S. v. Acme Process Equipment Co., 385 U.S. 138 (1966) - Anti-kickback case Pan Am Petroleum & Transportation Co. v.
U.S., 273 U.S. 456 (1927) - U.S. did not have to provide compensation for benefits conferred

6. Anti-kickback Act of 1986 (41 USC § 51)

kickbacks to primes from subcontractors on cost type contracts

7. Section 5 of Contract Disputes Act (41 U.S.C. § 604)

if a contractor cannot support a claim and it is attributable to misrepresentation of fact or fraud, the contractor is liable for an amount equal to such unsupported part of the claim plus the cost of reviewing the claim.

C. obtaining assets

1. Federal Debt Collection Procedures Act (28 USC § 3001)

sets standard federal procedures for debt collection

pre-judgment - can file suit and seek court order seizing property (must show proper need); defendant may not be told until after property is seized

2. civil forfeiture pursuant to 18 USC § 981

assets must be tied into money laundering

III. Civil-Criminal Coordination

A. criminal statutes most related:

18 U.S.C. § 286 - conspiracy to file false claims
18 U.S.C. § 287 - filing false claims
18 U.S.C. § 371 - conspiracy to defraud the U.S.
18 U.S.C. § 1001 - use of false statements

B. Differences with criminal law

- burden of proof - civil is preponderance of the evidence; criminal is beyond a reasonable doubt
- statute of limitations - discussed above
- discovery - federal rules - depositions; documents
- knowledge vs. intent

C. Need for coordination
(Attorney General's Memorandum of July 16, 1986)

- civil vs. criminal discovery
- collateral estoppel effect of criminal conviction
- access to grand jury materials

IV. Investigative tools

A. General program reviews, audits

B. IG subpoenas

C. Civil Investigative Demands

- authorized by 31 USC § 3733
- can seek documents, get written answers to interrogatories, or take depositions
- must be in support of potential False Claims Act suit
- must be signed by the Attorney General
- investigation done by "false claims law investigator" can be DOJ lawyer, investigator
- results can't be shared with agency

D. Grand Jury materials

U.S. v. Sells Engineering, 463 U.S. 418 (1983) and U.S. v. Baggot, 463 U.S. 476 (1983)

access to civil attorneys is limited by Criminal Procedure Rule 6 (e)

to get access, we must show particularized need

a) needed to avoid a possible injustice in another proceeding (must be to assist in preparation or conduct of another judicial proceeding)

b) need for disclosure outweighs need for continued secrecy

c) request covers only materials needed

we must show more than inconvenience and cost savings

it is easier to get documents than testimony documents produced to a grant jury pursuant to a subpoena may not be subject to Rule 6(e)

V. Referral to the Civil Division

A. Statute of limitations

- when did the acts occur
- when did we find out
- who found out

- when were the claims submitted

B. Wrongful acts

- what were the false claims/statements
- how was the government defrauded

C. How did the programs operate

D. Damages

- are there any
- how were they determined
- if no actual damages, are there illegal profits
- bribery, kickbacks

E. How many false statements/claims

F. Defendant's financial status (collectability)

- corporation/individual
- are assets being concealed
- are assets being dissipated

G. Evidence

- documents - government, defendant, others
- interviews
- audits, investigative reports

H. Other possible defendants

QUI TAM PROBLEMS

I. In General: Relations With Relators

A. Meeting with the relator before the qui tam complaint is filed

1. Advice regarding the merits of the claim
2. Advice regarding procedures
3. Assurances:

--original source
--criminal exposure of relator
--criminal investigation/prosecution of anyone
--immunity
--share of recovery

4. Employment claims; pending state or federal litigation
5. The unrepresented relator; advice about counsel

B. Relations after relator files the qui tam complaint

1. Initial briefing
2. Investigation
3. Maintaining secrecy
4. Protecting investigative/government information
5. Employment litigation: potential interference with qui tam

C. The intervention decision; unadopted claims

II. The Relator As Employee/Insider Of The Oui Tam Defendant

A. Can you use materials given to you by the relator, which he has stolen?
B. Can you use tapes obtained by the relator in violation of state law?
C. Can you use materials given to you by the relator which he takes from the defendant at your suggestion?
D. What use can you make of information obtained by the relator (a high-level manager) concerning the defendant's defense of the investigation and suit; other privileged information such as internal investigation materials?

III. The Investigation

A. The seal

B. Extensions of time

IV. Litigation

A. Discovery
B. Motion practice
C. Trial

V. Settlement

A. Getting the relator on board

B. "Inability to pay" settlements -- sharing defendant's financial information with the relator

C. Press/Confidentiality terms; terms relating to relator's future cooperation

D. The criminal side of the house

E. Defendant/relator settlements in declined cases; cases in which U.S. has intervened

VI. The Relator's Share

A. How to decide

B. Who decides

1. Role of AUSA
2. Role of DOJ
3. Input from defendants
4. Input from relator

C. What happens if no consensus is reached

CHAPTER 2

ADMINISTRATIVE REMEDIES

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Procurement Fraud Course
3 June 2002

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CHAPTER 2

ADMINISTRATIVE REMEDIES

One Contractor's View of Suspension and Debarment

Suppose last month you received a show cause letter from the contracting officer demanding that you advise her why she should not terminate your company for default for lack of progress. This month's letter is even worse. You receive by certified mail, return receipt requested, a letter from the contracting officer suspending your company from doing business with the agency. It seems that the agency thinks someone in your company stole government stock footage and used it in a commercial training film. Welcome to the twilight zone, the world of suspension and debarment. You will have more at stake with fewer rights or protections than in any other area of federal procurement. By the time its over, you will feel as if you've lived through the Spanish Inquisition, or at least the Star Chamber.

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I. INTRODUCTION AND OVERVIEW.

A. Policy. Protection of the Government's interest in contracting only with responsible contractors and not for purposes of punishment.

B. Historical Background. Development of statutory and administrative debarments, the common rule, reciprocity, and policy/rulemaking groups.

C. Regulatory framework for suspension and debarment, scope and effect.

D. Due process required before denying or limiting a property or liberty interest.

E. Effect of suspension or debarment on subsequent criminal prosecution.

F. Trends. Continued aggressive agency use of suspension and debarment, legislation of social policy by Legislative and Executive Branches, impact of acquisition reform, employment of felons by contractors, parallel proceedings.

G. Miscellaneous issues. Lead agency, bankruptcy, waiver of suspension and debarment in plea agreements, and show cause letters.

II. POLICY BASIS FOR SUSPENSION AND DEBARMENT.

A. Responsible Contractors. The underlying policy is that agencies may only contract with responsible contractors. FAR 9.402(a). Suspensions and debarments are discretionary measures that help to effectuate this policy. Id. Accordingly, the "[t]est for whether debarment is warranted is the present responsibility of the contractor." Delta Rocky Mountain Petroleum, Inc. v. Dep't of Defense, 726 F. Supp. 278, 280 (D. Colo. 1989).

B. Protection of Government's Interest—Not Punishment. Agencies may impose these remedies only to protect the Government and not to punish the contractor. FAR 9.402(b).

1. The debarment sanction is a nonpunitive means of ensuring compliance with statutory goals. Janik Paving & Constr. v. Brock, 828 F.2d 84, 91 (2d Cir. 1987).

2. These nonpunitive measures are justified because "[t]he security of the United States, and thus of the general public, depends upon the quality and reliability of items supplied by ... contractors." Caiola v. Carroll, 851 F.2d 395, 398 (D.C. Cir. 1988).

III. HISTORICAL BACKGROUND.

A. Early Cases.

1. Debarment is a reasonable tool to protect the Government, but some administrative due process is necessary to assure a fair outcome. Gonzalez v. Freeman, 334 F.2d 570 (D.C. Cir. 1964).

2. Government may suspend a contractor without prior notice, but must grant a swift post-deprivation opportunity to be heard. Horne Bros. v. Laird, 463 F.2d 1268 (D.C. Cir. 1972).

B. 1980s-1990s.

1. Courts generally uphold debarment decisions. Arbitrary and capricious standard of review. Silverman v. United States Defense Logistics Agency, 817 F. Supp. 846 (S.D. Cal. 1993).

2. Congress adds debarment to various laws ("statutory debarments"):

   a. Buy American, Davis Bacon, Walsh-Healey, Service Contract, Drug Free Workplace, and Clean Air/Clean Water Acts.

   b. Immigration and Nationality Act Employment Provisions. Executive Order (EO) No. 12989.

   c. Unfair Trade Practices. Statutes cited in FAR 9.403.

3. Ineligibility Provisions. Congress has included "ineligibility" provisions in various laws. Executive orders and initiatives also expand subject area of ineligibility determinations.

   a. Military Recruiters on Campus. National Defense Authorization Act (Pub. L. No. 104-106 (1996)). Defense Federal Acquisition Regulation Supplement (DFARS) 209.470. Universities prohibiting military recruitment on campus are prohibited from receiving federal contracts and grants and will be placed on GSA List. DFARS 209.470-1 (Policy) and DFARS 252.209-7005 (contract clauses). DOD has issued an interim rule, effective 13 January 2000, that revises DFARS 209.470, 243.105, and 252.209-7005 (65 Fed. Reg. 2056, January 13, 2000). Universities with institutions of higher education such as law schools that prohibit senior ROTC or military recruiting on campus may now be debarred under the interim rule (formerly only the law school, the "subelement," could be debarred). Update: as of 13 December 2001, the next step in the process is "undetermined." 66 FR 61518.

   b. Terrorist Countries Can Only Have Small Contracts. Section 843 of the FY 98 National Defense Authorization Act (Pub. L. No.105-85) requires the SECDEF to develop and maintain a list of all firms and subsidiaries of firms that are not eligible for defense contracts due to ownership or control of the firm by a terrorist

country. DOD contractors must disclose ownership by terrorist countries in all solicitations over $100,000. DFARS 209.104.70. Contracting officers shall not consent to any subcontract with a firm owned by the government of a terrorist country unless the agency head determines there is a compelling reason. DFARS 209.405-2.

c. MOH Counterfeiters. Section 8118 of the FY 1999 National Defense Authorization Act prohibits the use of DOD appropriated funds or other funds available to contracting officers to award a contract to, extend a contract with, or approve the award of a subcontract to any person who within the preceding 15 years has been convicted under Section 704 of Title 18, United States Code, of the unauthorized manufacture or sale of the Congressional Medal of Honor. DFARS 209.471 (October 14, 1999).

d. Child Labor. Executive Order No. 13126 (June 12, 1999) restricts the Government's purchase of goods made by forced or indentured child labor. The head of an agency may terminate a contract or suspend or debar a contractor that has furnished products made by forced or indentured child labor (FAR Case 99-608 pending). Update: Final rule issued 18 January 2001. 66 FR 5346.

e. Clinton Administration initiative to expand the definition of "contractor responsibility" to include the prospective contractor's compliance with tax, labor, environmental, antitrust, and consumer protection laws. The proposal would amend FAR 9.104-1 (64 Fed. Reg. 37360, July 9, 1999). The proposed rule generated 1500 comments, the largest number of comments in FAR history, with many industry groups and Federal agencies opposed to the proposed rule.

Update: The Federal Acquisition Regulatory Council (FAR Council) published in the Federal Register at 65 FR 80255, December 20, 2000, a final rule addressing contractor responsibility, labor relations costs, and costs incurred in legal and other proceedings. After further review, the FAR Council published an interim rule in the Federal Register at 66 FR 17754, 3 April 2001, staying that rule. The FAR Council intended the stay would last for 270 days from 3 April 2001, until 29 December 2001, or until

finalization of the proposed rule (entitled "Contractor Responsibility, Labor Relations Costs, and Costs Relating to Legal and Other Proceedings-Revocation) that was published in the Federal Register at 66 FR 17758, 3 April 2001, concurrently with the stay, whichever is sooner.

The FAR Council requested comments on the FAR interim rule-stay on the length of the stay. During the stay, the FAR text was restored to the text as it existed before January 19, 2001. In a separate document published concurrently with the interim rule-stay, the FAR Council published the proposed rule, requesting comments under that FAR case on revoking the 20 December 2000, final rule. Bottom Line: the December 2000 responsibility rules were revoked and the old rules restored. 66 FR 66984.

4. Administrative Debarments.

a. Procurement. Federal Acquisition Regulation (FAR), Subpart 9.4 See also DFARS 209.4; Army Federal Acquisition Regulation Supplement (AFARS) 9.4; other agency supplements.

b. Nonprocurement.

(1) Debarment from federal assistance programs grants, loans, loan guarantees, etc., under Government-wide "Nonprocurement Common Rule"(NCR), implemented for DOD at 32 CFR Part 25 (DOD grants regulation).

(2) How different from the FAR?

A company *proposed* for debarment under the NCR is not immediately excluded from Government contracts unless the company was previously suspended. A company proposed for debarment under the FAR is immediately excluded. Also, difference in 'flow-down:" procurement debarment flows down at most to first tier subcontractors, while nonprocurement debarment flows down to every tier affected by federal money. The Interagency Suspension and Debarment Committee (ISDC) is in the process of updating the NCR and redrafting it in "plain language" format.

Update: 23 January 2002, NCR proposed changes published at 67 FR 3266. The amendments propose several important changes.

First, mandatory lower tier application of an exclusion would be limited to the first procurement level under a nonprocurement covered transaction.

Second, the rule clarifies that the dollar threshold for prohibited lower tier procurement transactions with excluded persons is $25,000.

Third, the rule would eliminate the current requirement that agencies obtain written eligibility certifications from persons with whom they propose to enter into covered transactions. Instead of having to obtain written certifications, agencies would be permitted to use any reasonable method to ensure the enforcement of debarments and suspensions, including accessing an online list of excluded persons maintained by the General Services Administration (GSA).

C. Reciprocity Between Procurement and Nonprocurement. Debarment under either the FAR or Common Rule now results in ineligibility for both contracting and federal assistance programs. EO No. 12689 (1989). Final rule in 1995 applies reciprocity to suspensions and debarments after Aug. 25, 1995. See EO No. 12689 for exceptions.

D. Government and Private Bar Groups' Impact on Policy/ Rulemaking.

1. Debarment, Suspension and Business Ethics Committee (DSBEC). One of 20 standing committees that report directly to the DAR Council. Membership comprised of Army, Navy, Air Force, Defense Logistics Agency, General Services Administration, National Aeronautics and Space Administration, Department of Interior, Small Business Administration, and the Department of Veteran's Affairs. Rotating chair (three-year term) appointed by Director, Defense Procurement, currently filled by DLA. Previously chaired by Army.

2. Interagency Suspension and Debarment Coordinating Committee (ISDC): a non-chartered committee chaired by EPA. Membership is comprised of thirty-three

individual agency representatives of the Executive Branch. Coordinates policy, practices, lead agency, and sharing of information regarding various issues related to suspension and debarment. Serves as an advisory base for the Office of Management and Budget to examine possible changes in suspension and debarment.

3. American Bar Association, Section of Public Contract Law, Committee on Suspension and Debarment. Consists of a Chair, Vice-Chairs, and committee members from the Government and private bar. Studies, discusses, and issues advisory opinions on suspension and debarment issues. In 1994, published a deskbook: The Practitioner's Guide to Suspension and Debarment (updated in 1996).

E. 21st Century Update: COFC Demands Foolish Consistency. In a judgment published in December 2001, the Court of Federal Claims (COFC) set aside a U.S. Department of Agriculture (USDA) contracting suspension decision. The court ruled that the contracting activity's actions towards the contractor had been so logically inconsistent with the suspension that the suspension and debarment official's (SDO) action was arbitrary and capricious. The USDA had awarded a series of relatively small contracts to a firm during a period when the USDA had evidence that the firm had been dishonest in its prior dealings with the agency. The COFC held, in essence, that the USDA was arbitrary and capricious in later suspending the firm from federal contracting when it was competing for the award of much larger raisin contracts. Lion Raisin, Inc. v. United States 51 Fed. Cl. 238 (Fed. Cl. 2001), 2001 U.S. Claims LEXIS 258.

IV. SUSPENSION.

A. Suspension is an action taken by a suspending official under FAR 9.407 to disqualify a contractor temporarily from Government contracting and Government-approved subcontracting. FAR 9.403.

B. Causes for Suspension. FAR 9.407-2(a) through (c) provides that a suspending official may suspend a contractor upon "adequate evidence" of any of the following:

1. Commission of fraud or a criminal offense in connection with: (a) obtaining, (b) attempting to obtain, or (c) performing a public contract or subcontract;

2. Violation of Federal or State antitrust statutes relating to the submission of offers;

3. Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, or receiving stolen property;

4. Violations of the Drug-Free Workplace Act of 1988 (Pub. L. No.100-690);

5. Intentionally affixing a label bearing a "Made in America" inscription (or any inscription having the same meaning) to a product sold in or shipped to the United States, when the product was not made in the United States (see section 202 of the Defense Production Act (Pub. L. No. 102-558));

6. Commission of an unfair trade practice as defined in FAR 9.403;

7. Commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor or subcontractor; or

8. Any other cause of so serious or compelling a nature that it affects the present responsibility of a Government contractor or subcontractor.

C. Standard of Proof for Suspension: Adequate evidence.

1. Suspensions must be based on adequate evidence and not mere accusations. Horne Bros., Inc. v. Laird, 463 F.2d 1268, 1271 (D.C. Cir. 1972).

2. The FAR defines "adequate evidence" as information sufficient to support the reasonable belief that a particular act or omission has occurred. FAR 9.403.

3. "Adequate evidence" has been compared to that which is required to find probable cause sufficient to support an arrest or a search warrant. Transco Security, Inc. v. Freeman, 639 F.2d 318, 324 (6th Cir. 1981). Decision to suspend may be made without notice to the contractor but must include enough information for a meaningful response. Id.

4. An indictment for any of the causes listed in paragraph B, 1-7 above is "adequate evidence" for suspension. FAR 9.407-2(b).

5. Suspension based on an indictment does not violate the presumption of innocence; agency would be irresponsible not to suspend a contractor indicted for procurement fraud. James A. Merritt & Sons, Inc. v. Marsh, 791 F.2d 328, 331 (4th Cir. 1986).

6. Allegations in a civil complaint may be "adequate evidence" to suspend a contractor, where the complaint is sufficiently detailed in information to enable suspending official to conclude it reasonable that the United States Attorney had compiled evidence supporting or corroborating the allegations, hence providing adequate evidence. All Seasons Construction, Inc., et al. v. The Secretary of the Air Force, Civ. Action No. 05-1187 (W.D. La. 1995).

D. Immediate Action Required. A legal basis for suspension is not enough to justify suspension. Suspension is appropriate only when, "it has been determined that immediate action is necessary to protect the Government's interest." FAR 9.407-1(b).

E. Period of Suspension. FAR 9.407-4.

1. A suspension is a temporary measure imposed pending the completion of an investigation or legal proceeding. FAR 9.407-4(a). However, upon initiation of "legal proceedings", suspension is indefinite until proceedings are completed. In such cases, suspensions exceeding three years have been upheld. Frequency Electronics, Inc. v. United States, Civ. Action No. 97-230A (E.D. Va. 1997).

2. General Rule. The period of suspension should not exceed 12 months if legal proceedings are not instituted within 12 months after the date of the suspension notice. The Department of Justice can request an extension of up to six additional months where no legal proceedings have been initiated. (The suspension may not exceed a total of 18 months unless legal proceedings have been instituted within that period). FAR 9.407-4(b)

V. DEBARMENT.

A. Debarment. Action taken by a debarring official under FAR 9.406 to exclude a contractor from Government contracting and Government-approved subcontracting for a reasonable specified period. FAR 9.403.

B. Causes for Debarment. FAR 9.406-2.

1. The debarring official may debar a contractor for a conviction of or a civil judgment pursuant to FAR 9.406-2(a) for the following:

   a. Commission of fraud or a criminal offense in connection with: (1) obtaining, (2) attempting to obtain, or (3) performing a public contract or subcontract;

   b. Violation of Federal or State antitrust statutes relating to the submission of offers;

   c. Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, or receiving stolen property;

   d. Intentionally affixing a label bearing "Made in America" inscription (or any inscription having the same meaning) to a product sold or shipped to the United States, when the product was not made in the United States (see section 202 of the Defense Production Act (Pub. L. No. 102-558)); or

   e. Commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor or subcontractor.

2. Under FAR 9.406-2(b), a debarring official may also debar a contractor based upon a "preponderance of the evidence" for the following:

   a. Violation of the terms of a Government contract or subcontract so serious as to justify debarment, such as:

      (1) Willful failure to perform in accordance with the terms of one or more contracts; or

      (2) A history of failure to perform, or of unsatisfactory performance of, one or more contracts.

   b. Violation of the Drug-Free Workplace Act of 1988 (Pub. L. No. 100-690); or

   c. Intentionally affixing a label bearing a "Made in America" inscription (or any inscription having

the same meaning) to a product sold in or shipped to the United States, when the product was not made in the United States (see section 202 of the Defense Production Act (Pub. L. No. 102-558)) (Note: DFARS 209.406-2 requires a determination regarding debarment upon conviction of 10 U.S.C.2410f within 90 days of conviction. A determination not to debar requires a report to the Director of Defense Procurement);

d. Commission of an unfair trade practice as defined in FAR 9.403;

e. Attorney General Determination – violation of Immigration and Nationality Act employment provisions (see EO No. 12989).

3. Under FAR 9.406-2(c), a contractor may be debarred for any other cause of so serious or compelling a nature that it affects the present responsibility of a Government contractor or subcontractor.

C. Debarment Criteria/Guidance.

1. Standard of Proof for Debarment is preponderance of the evidence: proof that, compared with information opposing it, leads to the conclusion that the fact in issue is more probably true than not. FAR 9.403.

2. The mere existence of grounds for debarment does not mean that the debarring official must debar the contractor. Rich-Sea Pak Corp. v. Janet Cook, CV293-44 (S.D. Ga. 1993).

3. The debarring official should consider the seriousness of the offense and any remedial measures or mitigating factors. FAR 9.406-1(a). Mitigating factors listed at FAR 9.406-1(a) are:

a. Existence of standards of conduct and internal controls at the time of the misconduct;

b. Disclosure of the misconduct to the Government;

c. Extent of contractor investigation;

d. Contractor cooperation in the Government's investigation;

e. Contractor payment of civil and criminal fines and restitution;

f. Implementation of disciplinary measures against wrongdoers;

g. Implementation of remedial measures;

h. Agreement by contractor to revise standards of conduct and internal controls;

i. Contractor has had adequate time to repair his organization; and

j. Contractor's management understands the seriousness of the misconduct.

4. Remedial measures must be adequate to convince the debarring official that the Government's interests are not at risk; the Government has broad discretion in ensuring the present responsibility of the contractor such that the remedial measures taken by the contractor adequately protect the Government's interests. Robinson v. Cheney, 876 F.2d 152, 160-61 (D.C. Cir. 1989).

5. Aggravating Factors. Although the FAR does not list aggravating factors, some facts which bear directly on the present responsibility of the contractor are: (a) severity of the wrongdoing; (b) frequency and duration of the misconduct; (c) pattern or prior history of wrongdoing; (d) failure to accept responsibility for the misconduct; (e) positions of the individuals involved; (f) pervasiveness of the wrongdoing in the organization, and (g) failure to take complete corrective action.

D. Period of Debarment. FAR 9.406-4.

1. General Rule. Debarment should be for a period commensurate with the seriousness of the offense. Normally, this period should not exceed three years, considering any periods of suspension with several exceptions:

a. Drug-Free Workplace Act. A violation of the Drug-Free Workplace Act may result in a debarment of up to five years. FAR 9.406-4(a).

b. Debarments based on Attorney General determinations of lack of compliance with the Immigration and Nationality Act employment provisions shall be for one year. FAR 9.406-2(b)(2).

2. Three years is not an absolute limit. Although the FAR sets three years as the general upper limit, the regulations do not prohibit an agency from debarring a contractor for a period greater than three years, providing a reasonable explanation for the extended period is provided. Coccia v. Defense Logistics Agency, 1992 U. S. Dist. LEXIS 17386 (E.D. Pa. 1992) (upholding a 15 year debarment).

3. The period of debarment may be extended if the extension is necessary to protect the interests of the Government; however, the extension cannot be based solely on the grounds supporting the original period. FAR 9.406-4(b). Court upheld extension of debarment period based on conviction for actions similar to those leading to fact based debarment. Conviction was "new fact or circumstance." Wellham v. Cheney, 934 F. 2d 305, 309 (11th Cir. 1991).

4. The debarring official may also reduce the period of debarment. FAR 9.406-4(c).

VI. SCOPE OF SUSPENSION AND DEBARMENT.

A. Organizational Elements. Normally extends to all divisions or other organizational elements of a contractor unless specifically limited by the Suspending and Debarring Official. FAR 9.406-1(b) and 9.407-5.

B. Affiliates.

1. Business concerns, organizations, or individuals where one either controls or has the power to control the other; or a third party controls or has the power to control both. FAR 9.403.

2. Must be specifically named, given written notice, and offered an opportunity to respond.

3. Indicia of control include interlocking management or ownership, identity of interests among family members. ALB Industries, 61 Comp.Gen. 553, B-207335 (1982) (shared facilities and equipment and common use of employees).

4. "New Company." A business entity organized following the suspension, debarment, or proposed debarment of a contractor which has the same or similar management, ownership, or principal employees as the ineligible contractor. Howema Bau-Gmbh, B-245356, 91-2 CPD 214 (1991).

C. Imputation.

1. The fraudulent, criminal, or other seriously improper conduct of an individual may be imputed to the contractor when the conduct occurred in connection with the individual's performance of duties on behalf of the contractor, or with the contractor's knowledge, approval, acquiescence. The contractor's acceptance of the benefit derived from the conduct is evidence of such knowledge, approval, or acquiescence. FAR 9.407-5 and 9.406-5(a).

2. Likewise, the misconduct of the contractor may be imputed to an individual within the organization upon a showing that the individual "participated in, knew of, or had reason to know of the contractor's conduct." FAR 9.407-5 and 9.406-5(b). "Should have known" is not sufficient to meet the requirement. Determination must be based on information actually available to the individual. Novicki v. Cook, 946 F.2d 938 (D.C. Cir. 1991).

VII. PUBLICATION/EFFECT OF A SUSPENSION OR DEBARMENT.

A. Consolidated List of Contractors Debarred, Suspended, and Proposed for Debarment. The General Services Administration (GSA) maintains a consolidated list of all contractors debarred, suspended, and proposed for debarment. FAR 9.404.

B. Web Site: Excluded Parties List System. The GSA List of Parties Excluded from Federal Procurement and Nonprocurement Programs is available at http://www.arnet.gov/epls. The web site is updated daily and is accessible free of charge.

C. Government-Wide Exclusion. Agencies will not solicit offers from, award contracts to, renew or extend existing contracts with, or consent to subcontracts with contractors suspended, proposed for debarment, or debarred, unless the acquiring agency's head or designee determines in writing that there is a compelling reason to do so. FAR 9.405(b).

D. Additional Effects.

1. Exclusion from conducting business with the Government as representatives or agents of other contractors and from acting as individual sureties. FAR 9.405(c).

2. Exclusion from nonprocurement transactions with the Government such as grants, cooperative agreements, scholarships, fellowships, contracts of assistance,

loans, loan guarantees, subsidies, insurance, payments for specified use, and donation agreements. E.O. 12549.

3. Restrictions on subcontracting. FAR 9.405-2.

a. Subcontracts subject to Government consent – may only be approved/awarded if the agency head or SDO states in writing that there are compelling reasons to do so.

b. Contractors may not enter into subcontracts in excess of $25,000 with suspended, proposed for debarment, or debarred contractors, unless there is a compelling need.

E. Sales Contracts. Suspension from procurement contracts does not automatically suspend a contractor from sales contracts (contracts to buy items from the Government). Alamo Aircraft Supply, B-252117, Jun. 7, 1993, 93-1 CPD 436. The DLA Special Assistant for Contracting Integrity is the exclusive representative of the Secretary of Defense to suspend and debar contractors from the purchase of federal personal property. DFARS 209.403 (3).

F. Continuation of Current Contracts.

1. Agencies may continue with current contracts despite the imposition of a suspension or debarment. FAR 9.405-1 (a). Agencies may not, however, "renew or otherwise extend the duration of current contracts" without compelling reasons. FAR 9.405-1(c).

2. IDIQ Contracts. Ordering activities may continue to place orders against existing IDIQ contracts. FAR 9.405-1(b). However, if the contract's guaranteed minimum amount has been met or exceeded, no further orders may be placed against the contract. DFARS 209.405-1(b); see, Procurement Fraud Division Note, The Army Lawyer, Dec. 2001 at 35.

VIII. DUE PROCESS.

A. *De Facto* Debarments. *De facto* debarments are not permitted.

1. An agency cannot simply refuse to contract with a contractor without providing the procedural safeguards afforded a contractor facing debarment. Art Metal-USA, Inc. v. Solomon, 473 F. Supp. 1, 5 (D.D.C. 1978). Agency actions that effectively exclude a contractor without these safeguards may constitute an

impermissible de facto debarment. Old Dominion Dairy Products, Inc. v. Secretary of Defense, 631 F.2d 953 (D.C. Cir. 1980) (Plaintiff sued defendant government after government rejected its bids on account of plaintiff's alleged lack of integrity. Plaintiff claimed it was denied due process because it was not notified of the charges against it and had no opportunity to respond. The district court rejected plaintiff's claims and entered judgment in favor of defendant. The court of appeals held that government's conduct injured a liberty interest of plaintiff; namely, plaintiff's right to be free from stigmatizing governmental defamation. As a result of government's conduct, plaintiff lost government employment and was foreclosed from other employment opportunities).

2. Repeated nonresponsibility determinations may constitute a de facto debarment; fair play requires that if an agency is going to debar a contractor, it must use the debarment procedures. Leslie & Elliot Co. v. Garrett, 732 F. Supp. 191, 197-98 (D.D.C. 1990). But see Cubic Corp. v. Cheney, 914 F.2d 501 (D.C. Cir. 1990) (nonresponsibility determination is not the equivalent of a suspension if it is based on the contractor's lack of integrity).

3. Government may not maintain a list of contractors that it deems not to have complied with a law, regulation, or executive order unless the contractors have been afforded due process prior to placement on the list. Such practice tantamount to debarment. Illinois Tool Works v. Marshall, 601 F.2d 943 (7th Cir. 1979).

4. Intent: the Key Issue. De facto debarment occurs when the government uses nonresponsibility determinations as a means of excluding a firm from government contracting or subcontracting, rather than following the debarment regulations and procedures set forth at FAR Subpart 9.4. A necessary element of a de facto debarment is that an agency intends not to do business with the firm in the future. Quality Trust, Inc., B-289445, 2002 U.S. Comp. Gen. LEXIS 21.

B. Procedural Due Process. See generally DFARS, Appendix H.

1. Notice.

a. The contractor is provided written notice of the proposed action. A copy of the administrative record usually accompanies the notice. FAR 9.406-3(c).

b. The contractor has 30 days within which to submit in person, or in writing, opposition to the action. FAR 9.406-3(c)(4).

2. Debarring Officials. DFARS 209.403.

a. Army. Commander, U.S. Army Legal Services Agency is the primary "debarring official" for Department of the Army. In addition, the Army has two overseas "debarring officials:" (1) Deputy Judge Advocate, U.S. Army Europe and Seventh Army; and (2) Staff Judge Advocate, U.S. Eighth Army.

b. Navy: General Counsel of the Navy.

c. Air Force: Deputy General Counsel (Contractor Responsibility).

d. Defense Logistics Agency: The Special Assistant for Contracting Integrity.

3. Nature of proceedings—two step debarment process:

a. Step 1: Presentation of matters in opposition.

b. Step 2: Fact finding procedure—occurs only when the contractor's presentation during Step 1 raises a genuine dispute over a material fact.

4. Presentation of Matters in Opposition. DFARS H-103.

a. Contractor submits, in writing or through a representative, information and argument in opposition to the proposed action, to include any information that may raise a material issue of fact. Written matters in opposition must be submitted within 30 days from receipt of notice of action. DFARS H-103(c).

b. In-person presentation. DFARS H-103(b).

(1) Informal meeting, non-adversarial in nature.

(2) SDO and/or agency representatives may ask questions.

c. Contractor may, within five days of submitting these matters, submit a written statement

outlining the material facts in dispute, if any. DFARS H-103(a).

5. Fact-finding Proceeding. If material facts are in dispute, there will be no fact finding procedure, unless the action is a suspension and the proposed action is based on an indictment. DFARS H-104(a).

   a. The SDO designates a fact-finder to conduct a fact-finding proceeding. DFARS H-104(a). Under Army practice, if the suspending and debarring official determines that there is a genuine dispute as to a material fact, he will appoint a military judge to conduct a hearing.

   b. Procedures.

      (1) Normally held within 45 working days of the presentation of matters in opposition. DFARS H-104(b).

      (2) Government and contractor may appear in person and present evidence DFARS H-104(c).

      (3) Federal Rules of Evidence and Civil Procedure do not apply. Hearsay may be presented. DFARS H-104(d).

      (4) Live testimony is permitted. DFARS H-104(e).

   c. The fact-finder will provide written findings of fact to the SDO. DFARS H-106(a). Standard of proof: preponderance of the evidence. DFARS H-106(b).

6. Notice of decision. The suspending and debarring official will notify the contractor of his decision within 30 days after final opposition submitted (where no fact finding) or 30 days after fact finding complete. DFARS H-106(d).

7. Review of Suspending and Debarring Official's decision.

   a. No agency review.

   b. Judicial review. An agency's decision to debar a contractor is subject to review under the Administrative Procedure Act. Silverman v. Defense Logistics Agency, 817 F. Supp. 846, 848

(S.D. Cal. 1993). The agency decision is subject to an arbitrary and capricious standard of review. Id.

c. Exhaustion of administrative remedies required before court will review administrative process. Peter Kiewit Sons' Co. v. U.S. Army Corps of Engineers, 714 F. 2d 163 (D.C. Cir. 1983). CONSPEC Marketing and Manufacturing Co., Inc. v. Gray, 1992 U.S. Dist. LEXIS 2845 (D. Kan. 1992).

d. APA Review limited to administrative record unless contractor can make a strong showing of government bad-faith or improper conduct in making the decision. Alabama-Tombigbee Rivers Coalition v. Norton, 2002 U.S. Dist. LEXIS 1769, Jan. 29, 2002.

IX. EFFECT ON A SUBSEQUENT CRIMINAL PROSECUTION.

A. Double Jeopardy Clause. The double jeopardy clause is not a bar to a later criminal prosecution because debarment sanction is civil and remedial in nature. The mere presence of a deterrence element is insufficient to render a sanction criminal, as deterrence "may serve civil as well as criminal goals." Hudson v. United States, 118 S. Ct. 488 (1997).

B. Debarment is a "Civil Proceeding," Not a Criminal Penalty. In United States v. Hatfield, 108 F.3d 67, 69-70 (4th Cir. 1997), the court concluded debarment is a "civil proceeding," not a criminal penalty.

X. TRENDS.

A. Aggressive Use of Suspension and Debarment. Agencies continue the aggressive use of suspension and debarment, as evidenced by recent statistics. See Steven A. Shaw, Suspension and Debarment: The First Line of Defense Against Contractor Fraud and Abuse, *The Reporter*, Vol. 26, No. 1.

B. Use of Suspension and Debarment to Enforce Social Policy. Congress and President continue to use suspension and debarment to enforce social policy.

C. Impact of Acquisition Reform on Suspension and Debarment.

1. Emphasis on review of past performance raises "de facto debarment" concerns.

2. Some certification requirements eliminated by regulations implementing the Clinger-Cohen Act of 1996

(subcontractor kickbacks, negotiation representations, commercial item certifications).

3. Amendments to the Procurement Integrity Act, 41 U.S.C. § 423, eliminated procurement integrity certifications. Implementing regulations for the Procurement Integrity Act are currently being rewritten in plain language. 65 FR 16758, March 29, 2000. Comments regarding proposed rule are due by May 30, 2000. Update: Final rule issued 20 March 2002. 67 FR 13057.

4. "Partnering with contractors" philosophy raises concerns of overlooking fraud.

5. Nonprocurement Common Rule (32 CFR Part 25) has been rewritten in plain language. 67 FR 3266.

D. GSA CODE FF: Restrictions on Employment of Contractors Convicted of Fraud under DOD contracts. DOD has issued a DFARS amendment expanding the list of positions in which contractors and subcontractors may not employ convicted felons. Term of the prohibition is a minimum of five years. This rule further implements 10 U.S.C. § 2408. DFARS 203.570-2 and 252.203-7001 (March 25, 1999). DOD policy states that:

(a) A contractor or subcontractor shall not knowingly allow a person, convicted after September 29, 1988, of fraud or any other felony arising out of a contract with the DoD, to serve-

(1) In a management or supervisory capacity on any DoD contract or first-tier subcontract;

(2) On its board of directors;

(3) As a consultant, agent, or representative; or

(4) In any capacity with the authority to influence, advise, or control the decisions of any DoD contractor or subcontractor with regard to any DoD contract or first-tier subcontract.

DFARS 203.570-2(a).

E. DOJ "Parallel Proceedings Philosophy." Cases are evaluated from initiation for civil as well as criminal action. Encourages aggressive use of suspension and debarment remedy.

F. Progress Payment Fraud. A recent Sixth Circuit case illustrates difficulties in obtaining a conviction for progress payment fraud where the contractor has paid some, but not all, subcontractors. United States v. Gatewood, 173 F.3d 983 (6th Cir. 1999).

XI. MISCELLANEOUS ISSUES.

A. Lead Agency Determinations: "Yockey Memorandum," September 28, 1992. Agency with the predominant financial interest" will assume lead to debar. Subcontracting interests also considered. Issue: how do we determine predominant financial interest? Sheer dollar amounts; dollar amounts in current fiscal year, or over a period of time; "importance" of program?

B. Bankruptcy. Automatic stay provisions of the U.S. Bankruptcy Code do not prohibit suspension and debarment. Eddleman v. U.S. Dep't of Labor, 923 F.2d 782 (10th Cir. 1991) (DOL's pursuit of debarment was primarily to prevent unfair competition in the market by companies who pay substandard wages and thus a proper exercise of its police power and thus not subject to automatic stay).

C. Waiver of Suspension and Debarment Remedy in Plea Agreements. AUSA's have no authority to waive the remedy.

D. Show Cause Letters. Inquiries from agencies to contractors where there is insufficient evidence of misconduct to suspend or debar. Highly recommended by Yockey Memorandum: "[w]hen appropriate prior to suspension, I want companies to be informed that we have extremely serious concerns with their conduct, that their suspension is imminent and that they may contact the suspension official, or his designee, if they have any information to offer on their behalf."

XII. ADMINISTRATIVE SETTLEMENT AGREEMENTS IN LIEU OF SUSPENSION AND DEBARMENT.

A. Desired Preconditions.

1. Restitution.

2. Correction of the flawed procedures that resulted in the misconduct.

3. Discipline of blameworthy individuals.

4. Assurance that appropriate standards of ethics and integrity are in place and are working.

5. Otherwise satisfactory contract performance.

6. SDO is convinced that contractor is not so lacking in present responsibility as to threaten integrity of Government procurement.

B. Common Features.

1. Term of three years.

2. Company has installed an ethics code, government contracting policies and procedures, and other appropriate controls (quality control, internal audit, personnel background checks, etc.). Periodic training of employees.

3. Contractor-financed outside audits of the ethics process and other corrective action. Employment of ombudsman (external) and/or ethics director (internal).

4. Periodic reporting to debarring official.

5. Provision for compliance visit by enforcing agency.

6. Violation of the terms of the agreement is separate grounds for debarment.

7. Administrative fee of $2,000 - $10,000 depending on size of company to reimburse expenses associated with compliance visits.

8. Investigative cost reimbursement where substantiated and unusually high due to contractor lack of cooperation.

C. Interrelationship with *qui tam* cases: Ninth Circuit Muddies the Water. The relator filed a *qui tam* action against the corporation, his former employer, for submitting falsified records to the United States and failing to complete all required testing of flight data transmitters (FDTs). The United States intervened in the suit, settled it, and paid the relator his share of the recovery. The United States then prosecuted a criminal case based on the corporation's (1) false reporting, (2) incomplete testing, and (3) use of inadequate damping fluid in the FDTs. After that case ended, the relator filed another qui tam action based on the corporation's use of the inadequate damping fluid. The United States declined to intervene, and the corporation obtained dismissal of the second civil suit. The United States initiated a debarment proceeding against the corporation. After those two parties settled that proceeding, the relator sought a share of the cash payment

promised as part of the settlement. The district court denied his motion for an order directing the United States to give him a share of those proceeds. The instant court reversed. The debarment proceeding was an "alternate remedy" within the meaning of 31 U.S.C.S. § 3730(c)(5). The court reversed and remanded for further proceedings. Further, the court noted that if the relator was entitled to receive a share of the settlement, he was entitled to a share of all the proceeds recovered, not just the cash portion of the settlement. United States *ex rel.* Barajas v. United States, 238 F.3d 1004 (9th Cir 2001).

XIII. SUSPENSION/DEBARMENT SUMMARY AND CONCLUSION.

A. DOD agencies continue to use suspension and debarment as an effective fraud-fighting tool. Civilian agencies are increasingly interested in expanding the use of the remedy.

B. Legislative and Executive Branches continue to use suspension and debarment to enforce social policy.

C. Important to coordinate suspension and debarment actions among all agencies with interests due to reciprocal effects.

XIV. COORDINATION OF REMEDIES

A. References.

1. Department of Defense Directive 7050.5, Subject: Coordination of Remedies for Fraud and Corruption Related to Procurement Activities, 7 June 1989 [DOD Directive 7050.5].

2. Federal Acquisition Regulation, Subpart 9.4 -- Debarment, Suspension, and Ineligibility.

3. Defense FAR Supplement, Subpart 209.4 -- Debarment, Suspension, and Ineligibility [DFARS].

4. Defense Logistics Agency Regulation 5500.10, Subject: Combating Fraud in DLA Operations.

5. Army Regulation 27-40, Litigation, Chapter 8, Remedies in Procurement Fraud and Corruption, 19 September 1994 [AR 27-40].

6. SECNAV INSTRUCTION 5430.92B, Subject: Assignment of Responsibilities to Counteract Fraud, Waste, and Related Improprieties Within the Department of the Navy.

7. Air Force Policy Directive 51-11, Subject: Coordination of Remedies for Fraud and Corruption Related to Air Force Procurement Matters, 21 October 1994.

8. Air Force Instruction 51-1101, Subject: The Air Force Procurement Fraud Remedies Program. November 1994.

B. Introduction.

1. Agency regulations implement DOD Directive 7050.5. Copy found at Appendix D, AR 27-40.

2. The fraud mission established in DOD Directive 7050.5. Each of the DOD Components shall monitor, from its inception, all significant investigations of fraud to ensure all appropriate remedies are pursued expeditiously.

3. The "inception" of a fraud investigation.

4. DODIG oversight responsibility.

5. Determination of Lead Agency Responsibility. Interagency coordination is required in cases where the contractor has contracts with more than one federal agency. The DOD agency that has the predominant financial interest should be designated the "lead agency." Yockey Memorandum (Under Secretary of Defense, September 28, 1992). That agency has authority to suspend or debar the contractor. In the event of disputes among DOD agencies on this issue, the matter will be referred to the Director of Defense Procurement for resolution.

C. Remedies.

1. Criminal prosecution.

2. Civil litigation.

3. Contract remedies.

4. Administrative remedies.

5. Suspension and debarment.

6. Administrative settlement agreements.

D. Key Elements of the Army Procurement Fraud Program.

1. Procurement Fraud Division (PFD) is single centralized organization within the Army to coordinate and monitor criminal, civil, contractual, and administrative remedies in significant cases of fraud or corruption relating to Army Procurement.

2. Fraud remedies coordination assures that commanders and their contracting officers take, in a timely manner, all applicable criminal, civil, contractual, and administrative remedies.

3. Decentralized responsibility upon the local commander for operational matters such as reporting and remedial action.

4. Continuous case monitoring by The Judge Advocate General's PFD from the time suspected fraud is first reported until final disposition.

5. Command-wide fraud awareness training.

E. PFD Management Responsibilities.

1. Coordinate disposition of, and monitor, Army contract fraud and corruption cases.

2. Coordinate remedies.

3. POC for receipt and dissemination of DOD safety alerts in fraud cases.

4. POC in Army for voluntary disclosure cases.

5. Maintain active liaison with USACIDC, DCIS, and other investigative agencies.

6. Coordinate with DOJ and United States Attorneys regarding significant civil and criminal procurement fraud cases.

F. MACOM And Subordinate Command Programs.

1. SJAs at MACOMs appoint a Procurement Fraud and Irregularities Coordinator (PFIC) for their command.

2. Chief Counsel and SJAs at Major Subordinate Commands with procurement advisory responsibility appoint an attorney as a Procurement Fraud Advisor (PFA) to manage the fraud program at their installations.

3. Reports/Recommendations transmitted through command channels to the PFIC for the affected MACOM.

4. PFAs and PFICs assure prompt notification of appropriate local CID or DCIS activities.

G. Procurement Fraud Advisors (PFAs): The Key To A successful Program.

1. Attorneys.

2. Qualifications -- Working knowledge of procurement, criminal, and civil litigation law, and familiarity with government agencies in the acquisition area.

H. PFA Tasks And Responsibilities.

1. Recognize the indicators of possible procurement fraud or irregularity and help identify potential cases.

2. Prepare Flash Reports (AR 27-40, para. 8-5b).

a. Required for all cases if there is substantial indication of fraud and/or the matter is referred for investigation.

b. Dispatch immediately to PFD and major command by fax. (PFD fax is (703) 696-1559).

3. Coordinate investigative and remedial actions at the installation/activity.

a. Provide support to criminal investigators and coordinate remedies actions with them.

b. Coordinate remedial actions and necessary participation by installation/activity personnel. Make sure that funds recovered in fraud recoveries that can be returned to the agency (rather than the U.S. Treasury)are credited to agency accounts, such as where contracts remain open. Obtain necessary fund citations and accounting classifications. Determine whether settlements can include return of products or services as well as money.

c. Interface with local DOJ officials.

d. Help identify and solve systemic or internal control breakdowns that may have contributed to problems.

4. Prepare comprehensive remedies plan (AR 27-40, para. 8-8).

   a. Should be prepared in close coordination with investigators and contracting officer but is PFA's responsibility.

   b. Must consider all remedies.

   c. Must consider adverse impact and safety concerns. Should support preparation of a comprehensive victim impact statement (VIS).

   d. Forward VIS to PFD and the major command in significant cases.

   e. Significant cases defined as cases involving:

      (1) Loss greater than $100K;

      (2) Top 100 DOD company;

      (3) Bribery, gratuities, or conflict of interest; or

      (4) Safety Issues.

5. Assist in preparation of necessary contracting officer's report (DFARS 9.406-3) and litigation reports (para.. 8-9, AR 27-40).

6. Inform MACOM and PFD of initial contact with U.S. Attorney's Office or DOJ.

7. Acts as installation/activity central coordination point for fraud matters.

I. Features Of Successful Installation Level Procurement Fraud Programs.

1. An effective working relationship between the criminal investigator, the PFA, and contract officers.

2. An aggressive approach that includes fraud awareness training and informational activity by the PFA.

3. An effective working relationship between the local U.S. Attorney's Office and the installation command counsel/staff judge advocate.

4. An active installation case management team and/or coordinating committee which both facilitates remedies

coordination in individual cases and identifies and solves management/ internal controls weaknesses.

5. Command support.

XV. CONCLUSION.

Information for this area not available.

CHAPTER 4

CONTRACT REMEDIES

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CONTRACT REMEDIES

The United States does not stand on the same footing as an individual in a suit to annul a deed or lease obtained from him by fraud. . . . The financial element in the transaction is not the sole or principle thing involved. This suit was brought to vindicate the policy of the Government. . . . The petitioners stand as wrongdoers, and no equity arises in their favor to prevent granting the relief sought by the United States. Pan Am. Petroleum and Transp. v. United States, 273 U.S. 456, 509 (1927).

I. INTRODUCTION.

A. Government Policy.

1. Department of Defense (DOD) policy requires the coordinated use of criminal, civil, administrative, and contractual remedies in suspected cases involving procurement fraud. See U.S. DEPT OF DEFENSE, DIR. 7050.5, COORDINATION OF REMEDIES FOR FRAUD AND CORRUPTION RELATED TO PROCUREMENT ACTIVITIES (7 June 1989); U.S. DEP'T OF ARMY, REG. 27-40, LITIGATION, 19 Sept. 1994; U.S. DEP'T OF AIR FORCE, DIR. 51-11, COORDINATION OF REMEDIES FOR FRAUD AND CORRUPTION RELATED TO AIR FORCE PROCUREMENT MATTERS, 21 Oct. 1994; U.S. DEP'T OF NAVY, INST. 5430.92A, OP-008, ASSIGNMENT OF RESPONSIBILITIES TO COUNTERACT FRAUD, WASTE, AND RELATED IMPROPRIETIES WITHIN THE DEPARTMENT OF THE NAVY, (20 Aug. 1987); .

2. Department of Justice (DOJ) policy requires the coordination of parallel criminal, civil, and administrative proceedings so as to maximize the government's ability to obtain favorable results in cases involving procurement fraud. See U.S. DEP'T OF JUSTICE, U.S. ATT'YS MAN. Ch. 1-12.000 (Coordination of Parallel Criminal, Civil, and Administrative Proceedings) June 1998.

3. Among the many remedies available, contractual remedies are a potentially powerful weapon in the government's battle against procurement fraud.

MAJ James M. Dorn
5th Procurement Fraud Course
June, 2002

B. Historical Right

1. Under common law, where a party to a contract committed an act of fraud affecting a material element of the contract, the fraudulent act constituted a breach on the part of the party committing the act. The innocent party could then, at its election, insist on continuation of contract performance, or void the contract. Once voided, the voiding party would be liable under equity to the other party for any benefit received. Stoffela v. Nugent, 217 U.S. 499 (1910); Diamond Coal Co. v. Payne, 271 F. 362, 366 (App. D.C. 1921) ("equity refuses to give to the innocent party more than he is entitled to").

2. Since the U. S. government was often viewed as acting in a "commercial capacity" when it engaged in commercial transactions, the rules of common law and equity applied to resolution of disputes. As such, if the government sought to rescind a contract, it was obligated to restore the contractor to the position it would be in, but-for the breach. Cooke v. United States, 91 U.S. 389, 398 (1875) ("If [the government] comes down from its position of sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there."); Hollerbach v. United States, 233 U.S. 165 (1914); United States v. Fuller Co., 296 F. 178 (1923).

3. The Supreme Court rejected the general rule that the government should be treated like any other party to a contract when fraud. Pan American Petroleum and Transport Co., v. United States, 273 U.S. 456 (1927).

4. Courts and boards have developed an implied or common-law right to terminate or cancel a contract in order to effectuate the public policy in a statute or regulation. See United States v. Mississippi Valley Generating Co., 364 U.S. 520, reh'g denied 365 U.S. 855 (1961); Four-Phase Sys., Inc., ASBCA No. 26794, 86-2 BCA ¶ 18,924.

5. A contractor that engages in fraud in dealing with the government commits a material breach, which justifies terminating the entire contract for default. Joseph Morton Co., Inc. v. United States, 3 Cl. Ct. 120 (1983), aff'd 757 F.2d 1273 (Fed. Cir. 1985).

II. CONTRACTING OFFICER AUTHORITY.

A. Actions Clearly Exceeding Authority. The Contract Disputes Act, 41 U.S.C. § 605(a), as implemented by FAR 33.210, prohibits any contracting officer or agency head from settling, paying, compromising or otherwise adjusting any claim involving fraud.

B. Actions Clearly Within KO Authority.

1. Refusing Payment. It is the plain duty of administrative, accounting, and auditing officials of the government to refuse approval and to prevent payment of public monies under any agreement on behalf of the United States as to which there is a reasonable suspicion of irregularity, collusion, or fraud, thus reserving the matter for scrutiny in the courts when the facts may be judicially determined upon sworn testimony and competent evidence and a forfeiture declared or other appropriate action taken. To the Secretary of the Army, B-154766, 44 Comp. Gen. 111 (1964).

2. Suspend Progress Payments. 10 U.S.C. § 2307(e)(2); Brown v. United States, 207 Ct. Cl. 768, 524 F.2d 693 (1975); Fidelity Construction, DOT CAB No. 1113, 80-2 BCA ¶ 14,819.

3. Withhold Payment.

4. When a debarment/suspension report recommends debarment or suspension based on fraud or criminal conduct involving a current contract, all funds becoming due on that contract shall be withheld unless directed otherwise by the Head of the Contracting Activity (HCA) or the Commander, U.S. Army Legal Services Agency. AFARS 9.406-3.

   a. Labor standards statutes provide for withholding for labor standards violations. WHA – 41 U.S.C. § 36; DBA – 40 U.S.C. § 276a-2; SCA – 41 U.S.C. § 353(a).

   b. Specific contract provisions may provide for withholding (e.g., service contract deductions for deficiencies in performance).

5. Terminate Negotiations. FAR 49.106 (terminate settlement discussions regarding a terminated contract upon suspicion of fraud); K&R Eng'g Co., Inc., v. United States, 222 Ct. Cl. 340, 616 F.2d 469 (1980).

6. Determine Contractor to be Nonresponsible. FAR Subpart 9.4.

III. CONTRACTUAL REMEDIES.

A. Denial of Claims.

1. Section 605(a) of the CDA prohibits an agency head from settling, compromising or otherwise adjusting any claim involving fraud. 41 U.S.C.S § 605(a) (LEXIS 2002). This limitation is reflected in FAR 33.210, which states that the authority of a contracting officer to decide or resolve a claim does not extend to the "settlement, compromise, payment, or adjustment of any claim involving fraud." Subpart 33.209 of the FAR further provides that contracting officers must refer all cases involving suspected fraud to the agency official responsible for investigating fraud.

2. As a practical matter, the term "denial" is a misnomer in that the contracting officer is precluded from making a final decision on a contractor's claim where fraud is suspected. As such, denial of a claim consists simply of doing nothing with the claim while other courses of action are pursued.

3. Denial of a claim should be viewed as simply the first of possibly many steps in the resolution of a fraudulent claim.

B. Counterclaims Under the CDA

1. IAW 41 U.S.C. § 604 (LEXIS 2002): "[i]f a contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim."

2. This provision of the CDA has been applied in only a small number of cases. This may in part be due to the deterrent effect of this statute. See United States ex. ral. Wilson v. North American Const., 101 F. Supp.2d 500, 533 (S.D. Tex 2000) (district court unwilling to enforce 41 U.S.C. § 604, in part because there were "very few cases applying 41 U.S.C. 604").

3. It is not possible to enforce this section of the CDA in litigation before the boards because of the language at 41 U.S.C. Section 605 (a), which states: "[t]he authority of this subsection shall not extend to a claim or dispute for penalties or forfeitures prescribed by statute or regulation which another Federal agency is specifically authorized to administer, settle or determine." The boards have generally interpreted this language as meaning only Department of Justice (DOJ) has the authority to initiated a claim under this provision. This is because (in the eyes of the boards) only DOJ has the authority to administer or settle disputes involving fraud under the current statutory scheme. See TDC Management, DOT BCA 1802, 90-1 BCA ¶ 22,627.

C. Default Terminations Based on Fraud.

1. Where a contractor challenges the propriety of a default termination before a court or board, the government is not precluded under the CDA from introducing evidence of fraud discovered after the default termination, and using that evidence to support the termination in the subsequent litigation.

2. Some grounds for default termination.

a. Submission of falsified test reports. Michael C. Avino, Inc., ASBCA No. 317542, 89-3 BCA ¶ 22,156.

b. Submission of forged performance and payment bonds. Dry Roof Corp., ASBCA No. 29061, 88-3 BCA ¶ 21,096.

c. Submission of falsified progress payment requests. Charles W. Daff, Trustee in Bankruptcy for Triad Microsystems, Inc. v. United States, 31 Fed. Cl. 682 (1994).

D. Voiding Contracts Pursuant to FAR 3.7

1. Subpart 3.7 of the FAR establishes a detailed mechanism for voiding and rescinding contracts where there has been either a final conviction for illegal conduct in relation to a government contract, or an agency head determination of misconduct by a preponderance of the evidence.

2. Subpart 3.7 of the FAR cites three specific authorities that empower the government to void or rescind contracts in instances of procurement fraud. They are:

   (1) 18 U.S.C. § 218, (LEXIS 2000);

   (2) Executive Order 12448, 50 Fed. Reg. 23,157 (May 31, 1985); and,

   (3) Subsection 27(e)(3) of the Office of Federal Procurement Policy Act (41 U.S.C.S. § 423 (LEXIS 2002)).

3. Under this FAR provision, a federal agency shall consider rescinding a contract upon receiving information that a contractor has engaged in illegal conduct concerning the formation of a contract, or there has been a final conviction for any violation of 18 U.S.C. §§ 201-224.

4. The decision authority for this provision is the agency head, which for DOD has been delegated to the Under Secretary of Defense (Acquisition, Technology, and Logistics).

5. No recorded cases of this provision of the FAR being applied.

E. Suspending Payments Upon a Finding of Fraud, FAR 32.006.

1. FAR 32.006 allows an agency head to reduce or suspend payments to a contractor when the agency head determines there is "substantial evidence that the contractor's request for advance, partial, or progress payments is based on fraud."

2. The authority of the agency head under this provision may be delegated down to Level IV of the Executive Schedule, which for the Department of the Army is the Assistant Secretary of the Army for Acquisition, Logistics, and Technology (ASA (ALT)).

3. This provision of the FAR is a potentially powerful tool in that the government can stay payment of a claim without the danger of a board treating the claim as a deemed denial, thus forcing the government into a board proceeding before the government's case can be developed.

4. Only one recorded board decision involving this provision of the FAR. TRS Research, ASBCA No. 51712, 2001-1 BCA ¶ 31,149 (contracting officer suspended payment on invoices pending completion of an investigation involving fraud allegation, but failed to seek written permission from the agency head to take such act; ASBCA found the government in breach of the contract and sustained the appeal).

F. Voiding Contracts pursuant to the Gratuities Clause, FAR 52.203-3.

1. Allows DOD to unilaterally void contracts upon an agency head finding that contract is tainted by an improper gratuity. Decision authority for the Department of the Army has been delegated to the ASA (ALT).

2. Authority stems from 10 U.S.C. § 2207, which requires the clause in all DOD contracts (except personal service contracts).

3. Considerable due process protections for the contractor.

4. Exemplary damages of between three to ten times the amount of the gratuity.

5. Procedures used very effectively in response to a fraudulent bidding scheme centered out of the Fuerth Regional Contracting Office, Fuerth, Germany. See Schuepferling GmbH & Co., ASBCA No. 45564, 98-1 BCA ¶ 29,659; ASBCA No. 45565, 98-2 BCA ¶ 29,739; ASBCA No. 45567, 98-2 BCA ¶ 29,828; Erwin Pfister General-Bauunternehmen, ASBCA Nos. 43980, 43981, 45569, 45570, 2001-2 BCA ¶ 31,431; Schneider Haustechnik GmbH, ASBCA Nos. 43969, 45568, 2001 BCA ¶ 31,264. See also Colonel Roger Washington, German Bribery Cases: Convicted German Contractor Loses Appeals to Recover Offsets, PROCUREMENT FRAUD UPDATE May 1998.

IV. RELATED REMEDIES

A. Use of Inspection Clause Rights.

1. Provisions include: FAR 52.246-2 (fixed-price supply); FAR 52.246-4 (fixed-price service); FAR 52.246-12 (fixed-price construction); FAR 52.246-3 (cost reimbursement supply); FAR 52.246-5 (cost reimbursement service).

2. General Inspection Clause Requirements. FAR Subpart 46.2.

   a. Contractor required to maintain an inspection system acceptable to the government. David B. Lilly Co., ASBCA No. 34678, 92-2 BCA ¶ 24,973.

   b. Government right to inspect work performed during the course of performance or before acceptance.

   c. Government right to require correction, replacement or rework of nonconforming tenders or to equitably reduce the contract price based on the decreased value of the nonconforming work.

   d. Government rights to perform correction, replacement, or rework, at the contractor's expense or to default terminate the contract if the contractor fails to perform directed corrective work.

3. Government's inspection test must be reasonable. Al Johnson Constr. Co., ENG BCA No. 4170, 87-2 BCA ¶ 19,952; General Time Corp., ASBCA No. 22306, 80-1 BCA ¶ 14,393; Nash Metalware Co. v. Gen. Servs. Admin., GSBCA No. 11951, 94-2 BCA ¶ 26,780.

4. Government Remedies Prior to Acceptance.

5. Nonconforming goods tendered within the delivery period.

   a. Reject the nonconforming goods.

   b. Accept nonconforming goods at a reduction in price.

   c. Require correction/replacement – must give contractor notice of defects and reasonable time to cure. Trataros Constr. Co., Inc., ASBCA No. 42845, 94-1 BCA ¶ 26,592.

6. Nonconforming goods delivered on required delivery date.

   a. Terminate for default if performance is not in substantial compliance with contract requirements.

   b. Accept nonconforming goods at a reduction in price. Federal Boiler Co., ASBCA No. 40314, 94-1 BCA & 26381.

   c. Require correction/replacement – must give contractor notice of defects and reasonable time. Andrews, Large & Whidden, Inc. and Farmville Mfg. Corp., ASBCA No. 30060, 88-2 BCA ¶ 20,542.

7. Nonconforming goods delivered on the required delivery date and which are in substantial compliance with contract requirements.

   a. Cannot terminate for default. Radiation Tech., Inc. v. United States, 366 F.2d 1003 (Cl. Ct. 1986).

   b. Must allow reasonable time to correct defects. Id.

c. Accept Nonconforming goods at reduction in price.

8. Nonconforming goods which the contractor has failed to correct or replace after a reasonable time.

a. Government may correct or replace defective items.

b. Government may contract with another contractor to correct or replace. Lenoir Contractors, Inc., DOTCAB No. 78-7, 80-2 BCA ¶ 14,459.

c. Terminate for default. Radiation Tech., Inc., supra.

9. Providing notice to the contractor.

a. Should be in writing.

b. Specify why goods/services are nonconforming.

c. Not required to inform contractor that fraud is suspected—coordinate to ensure fraud investigation is not adversely affected.

10. Remedies After Acceptance.

a. Revocation of acceptance for fraud.

(1) Elements of proof. Dale Ingram, Inc., ASBCA No. 12152, 74-1 BCA ¶ 10,436.

(a) Intent to deceive;

(b) A misrepresentation;

(c) Must be misrepresentation of fact, not of law, opinion, or judgment; and

(d) Government reliance on the misrepresentation to its detriment.

(2) No ASBCA jurisdiction over this remedy. 41 U.S.C. §§ 605 and 607.

b. Revocation of acceptance for gross mistake amounting to fraud.

(1) "Constructive" fraud as opposed to actual fraud. Catalytic Eng'g & Mfg. Corp., ASBCA No. 15257, 72-1 BCA ¶ 9,432; Kaminer Constr. Corp. v. United States, 488 F.2d 980 (Ct. Cl. 1973); Z.A.N. Co., ASBCA No. 25488, 86-1 BCA ¶ 18,612.

(2) Elements of proof are the same as for actual fraud except no need to prove intent to deceive. Must show a major mistake so serious that it would not be expected of a reasonable contractor.

(3) ASBCA has jurisdiction over this remedy. Z.A.N. Co., supra.

B. Exercise of Warranty to Correct Fraudulent Defect

1. Applicable provision: FAR 46.7.

2. Elements of Proof.

a. There is a defect.

b. The defect is within the scope of the warranty. S. Kane & Sons, Inc., VACAB No. 1316, 78-1 BCA ¶ 13,300.

c. The warranted defect was the most probable cause of the failure. R.B. Hazard, Inc., ASBCA No. 41061, 91-2 BCA ¶ 23,709; A.L.S. Elec. Corp., ASBCA No. 23128, 82-2 BCA ¶ 15,835.

d. The defect arose during the warranted period. Phoenix Steel Container Co., ASBCA No. 9987, 66-2 BCA ¶ 5814.

e. The contractor received the required notice under the warranty clause. Mercury Chem. Co., ASBCA No. 12554, 69-1 BCA ¶ 7730.

3. Remedies for Breach of Warranty. FAR 46.706(b)(2).

a. Correction or replacement of defective work.

b. Price reduction for lost value.

c. Correction or replacement of the work by another contractor or the government at the contractor's expense.

V. BOARD OF CONTRACT APPEALS' TREATMENT OF FRAUD.

A. Jurisdiction.

1. Theoretically, the boards are without jurisdiction to decide appeals tainted by fraud

a. Under the CDA, "[e]ach agency board shall have jurisdiction to decide any appeal from a decision of a contracting officer (1) relative to a contract made by its agency, and (2) relative to a contract made by any other agency when such agency or the Administrator has designated the agency board to decide the appeal." 41 U.S.C. § 607(d) (LEXIS 2002).

b. Because the CDA precludes contracting officers from issuing final decisions where fraud is suspected, and the boards only have jurisdiction over cases that can be decided by a contracting officer, the boards are effectively barred from adjudicating appeals involving fraud. See 41 U.S.C. § 605(a) (LEXIS 2002).

2. As a practical matter, the boards exercise a form a de facto jurisdiction in that a finding of fraud is often dispositive of the entire appeal

B. Dismissals, Suspensions and Stays.

1. Government must demonstrate that the possibility of fraud exists or that the alleged fraud adversely affects the Board's ability to ascertain the facts. Triax Co., Inc., ASBCA No. 33899, 88-3 BCA ¶ 20,830.

2. Mere allegations of fraud are not sufficient. General Constr. and Dev. Co., ASBCA No. 36138, 88-3 BCA ¶ 20,874. Four-Phase Systems, Inc., ASBCA No. 27487, 84-1 BCA ¶ 17,122.

3. Boards generally refuse to suspend proceedings except under the following limited circumstances:

a. When an action has been commenced in a court of competent jurisdiction, by the handing down of an indictment or by filing of a civil action complaint, so that issues directly relevant to the claim before the board are placed before that court;

b. When the Department of Justice or other authorized investigatory authority requests a suspension to avoid a conflict with an ongoing criminal investigation;

c. When the government can demonstrate that there is a real possibility that fraud exists which is of such a nature as to effectively preclude the board from ascertaining the facts and circumstances surrounding a claim; and

d. When an appellant so requests to avoid compromising his rights in regard to an actual or potential proceeding. See Fidelity Constr., 80-2 BCA ¶ 14,819 at 73,142.

C. Fraud as an Affirmative Defense.

1. Most often, the government elects to treat fraud as a jurisdictional bar, and pursues the issue in a motion to dismiss.

2. When fraud is cited as an affirmative defense, the boards generally treat the issue consistent with cases where it is presented as a jurisdictional bar. See ORC, Inc. ASBCA No. 49693, 97-1 BCA ¶ 28,750.

VI. CONCLUSION.

THINK ANTITRUST:

THE ROLE OF CRIMINAL ANTITRUST ENFORCEMENT IN FEDERAL PROCUREMENT

I. PREFACE

Price fixing, bid rigging and other typical antitrust violations have a more devastating effect on the American public than any other type of economic crime. Such illegal activity contributes to inflation, destroys public confidence in the country's economy, and undermines our system of free enterprise. In the case of federal procurement, such crimes increase the costs of government, increase taxes and undermine the public's confidence in its government.

Because government procurement officials receive bids and award government purchasing orders, they are in a good position to observe and identify violations of the antitrust laws. Other important players in the fight to maintain the free flow of competition include agency auditors-investigators, and local or state administrators of federally funded projects, and federal supervisors of such state activities. If all those involved in procurement have a working knowledge of the antitrust laws and understand how to identify violations, they can make a significant contribution to law enforcement.[1]

This paper, prepared by the Justice Department's Antitrust Division, is designed primarily for procurement and contract specialists, and for investigative and audit personnel. The text outlines the purposes of the antitrust laws, briefly describes what conduct violates the laws and what penalties may be imposed, and then focuses on how to detect price fixing and bid rigging. Steps that individual agency employees can take to seek out actual evidence of collusion **are suggested, along with ways that agency procurement can be administered to**

[1]Although these comments will be directed toward the purchasing process, they also apply to sales by the government of surplus items and other commodities on a competitive basis.

stimulate competition and inhibit anticompetitive behavior. Finally, we suggest methods that can be implemented on an agency-wide basis to sensitize procurement and auditing employees to antitrust violations and encourage them to THINK ANTITRUST.

II. ANTITRUST VIOLATIONS AND PUBLIC AGENCIES

As a major purchaser of goods and services, public agencies can be both prime targets for, and sensitive detectors of, antitrust violations. If you detect an antitrust violation, you can perform a triple public service: (1) You can end a practice that is costing your agency money and is costing consumers and taxpayers millions of dollars; (2) you can also bring monies to the treasury, since criminal penalties collected in antitrust enforcement go into the general treasury fund; and (3) you can help recoup the additional prices paid since the government may bring antitrust damage actions and actions under the False Claims Act.

III. FEDERAL ANTITRUST ENFORCEMENT

The Sherman Act (15 U.S.C. § 1) prohibits any agreement among competitors to fix prices.[2] Criminal enforcement of the Sherman Act is the responsibility of the Antitrust Division of the United States Department of Justice. Violation of the act is a felony punishable by a fine of up to $10 million for corporations, or twice the loss caused to the victims or twice the gain

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[2]The operative language of the act reads as follows:

> **Section 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy . . . shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding ten million dollars if a corporation or if any other person, three hundred and fifty thousand dollars or by imprisonment not exceeding three years, or both . . . . [2 July 1890, Chap. 647, sec. 1, 2b State. 209, as amended, 15 U.S.C.A. sec. 1.**

derived from the conspiracy, whichever is greater, and three years imprisonment and up to $350,000 or twice the loss or gain from the conspiracy, whichever is greater, for individuals. In addition to a criminal violation of the antitrust laws, collusion among competitors may also form the basis for violation of other federal criminal statutes, including the mail fraud statute (18 U.S.C. § 1341) and making a false statement to a government agency (18 U.S.C. § 1001). Both of these felony violations are punishable by a fine and imprisonment of up to 5 years. Civil action for injunctive relief, for actual damages under 15 U.S.C. § 15a and for double damages under the False Claims Act (31 U.S.C. § 231 et seq.), are also effective enforcement tools.

The Antitrust Division offers certain incentives to the business and legal communities to encourage prompt self-reporting of suspected violations. One important incentive that has been used with increasing frequency is the Division's Revised Amnesty Program.

In August 1993, The Antitrust Division expanded its Amnesty Program to increase the opportunities and raise the incentives for companies to self-report and cooperate with the Division. Under the old policy that was put into place in 1978, the grant of amnesty was not automatic, but rather an exercise of prosecutorial discretion, and was not available to any company once an investigation had begun. In 1993, The Amnesty Program was revised in three major respects: (1) Amnesty is automatic if there is no pre-existing investigation; (2) amnesty may still be available even if cooperation begins after the investigation is underway; and (3) all officers, directors, and employees who cooperate are protected from criminal prosecution. The Division's revised Amnesty Program was, and is, unique. No other U.S. government voluntary disclosure program offers as great an opportunity or incentive for companies to self-report and cooperate.

Today, the Amnesty Program is one of the Division's most effective and important generators of large cases, and it is the Department's most successful leniency program. Prior to 1993, the Division received amnesty applications at the rate of approximately one per year. Over the past several years, we have received, on average, more than one per month. Moreover, in the last two years, cooperation from amnesty applications has resulted in dozens of convictions and over one billion dollars in fines.

IV. BID RIGGING, PRICE FIXING, AND OTHER TYPES OF COLLUSION

Commencement of criminal prosecution under Section 1 of the Sherman Act, requires that the unlawful "contract, combination or conspiracy" have existed within the previous five years. The offense most likely to arise in a procurement context is commonly known as "price fixing" or "bid rigging," and also referred to as "collusion." An express agreement is not always necessary, and the offense can be established either by direct evidence (such as the testimony of a participant) or by circumstantial evidence (such as bid awards that establish a pattern of business being rotated among competitors). Any agreement or informal arrangement among independent competitors by which prices or bids are fixed is per se unlawful. Where a per se violation is shown, defendants cannot offer any evidence to demonstrate the reasonableness or the necessity of the challenged conduct. Thus, competitors may not justify their conduct by arguing that price fixing was necessary to avoid cut-throat competition, or that price fixing actually stimulated competition, or that it resulted in more reasonable prices. Bid rigging occurs when competitors reach any understanding not to compete. The understanding or agreement may involve a single contract or a series of contracts. The agreement or conspiracy may involve a single customer in the geographic area or multiple customers in a number of geographic areas. Competitors may agree not to bid or to limit their bidding to favor a firm they have selected to

win the award. Complimentary bids are frequently used to give the appearance of competition. Winning bids often are rotated among firms.

Collusion among competitors can take many forms. For example, competitors may take turns being the low bidder on a series of contracts, or they may agree among themselves to adhere to published list prices. It is not necessary that all competitors charge exactly the same price for a given item; an agreement to raise present prices by a certain increment is enough to violate the law. Other examples of price fixing include: (1) Agreement to establish or adhere to uniform price discounts; (2) agreements to eliminate discounts; (3) agreements to adopt a standard formula for the computation of selling prices; (4) agreements not to reduce prices without prior notification to others; (5) agreements to maintain specified discounts; (6) agreements to maintain predetermined price differentials between different quantities, types or sizes of products; and (7) agreements not to advertise prices. Usually, but not always, price-fixing conspiracies include mechanisms for policing or enforcing adherence to the prices fixed.

V. TYPICAL ANTITRUST VIOLATIONS

The following section describes common bid-rigging patterns that agency personnel may be able to recognize.

A. BID SUPPRESSION

In "bid suppression" or "bid limiting" schemes, one or several competitors (who would otherwise be expected to bid or who have previously bid) refrain from bidding or withdraw a previously submitted bid, so that a competitor's bid will be accepted. In addition, fabricated bid protests may be filed to deny an award to a non-conspirator.

B. COMPLEMENTARY BIDDING

"Complementary bidding" (also known as "protective" or "shadow" bidding) occurs when competitors submit tokens bids that are too high to be accepted (or if competitive in price, then on special terms that will not be acceptable). Such bids are not intended to secure the buyer's acceptance, but are merely designed to give the appearance of genuine bidding. This enables another competitor's bid to be accepted when the agency requires a minimum number of bidders.

C. BID ROTATION

In "bid rotation," all vendors participating in the scheme submit bids but by agreement take turns being the low bidder. A strict bid rotation defies the law of chance and suggests collusion.

Competitors may also take turns on contracts according to the size of the contract. Many cases of bid rigging have been exposed in which certain vendors or contractors got contracts valued above a certain figure, while others got contracts worth less than that figure. Subcontracting is another area for attention. If losing bidders or non-bidders frequently receive subcontracts from the successful low bidder, the subcontracts (or supply contracts) may be a reward for submitting a non-competitive bid or for not bidding at all.

D. MARKET DIVISION

Market division schemes are agreements to refrain from competing in a designated portion of the market. Competing firms may, for example, allocate specific customers or types of customers, so that one competitor will not bid (or will submit only a complementary bid) on contracts let by a certain class of potential customers. In return, his competitors will not bid on a class of customers allocated to him. For example, a vendor of office supplies may agree to bid only on contracts let by certain federal agencies, and refuse to bid on contracts for military bases.

Allocating territories among competitors is also illegal. This is similar to the allocation-of-customers scheme, except that geographic areas are divided instead of customers.

VI. DETECTING BID RIGGING, PRICE FIXING, AND OTHER TYPES OF COLLUSION

Certain patterns of conduct suggest that illegal restraints on trade have been established. The following is a checklist of some factors, any one of which may indicate collusion. Agency personnel should, therefore, be sensitive to their occurrence.

A. CHECKLIST FOR POSSIBLE COLLUSION

1. Some bids are much higher than published price lists, previous bids by the same firms, or engineering cost estimates. (This could indicate complementary bids.)
2. Fewer competitors than normal submit bids. (This could indicate a deliberate plan to withhold bids.)
3. The same contractor has been the low bidder and has been awarded the contract on successive occasions over a period of time.
4. There is an inexplicably large dollar margin between the winning bid and all other bids.
5. There is an apparent pattern of low bids regularly recurring, such as corporation "X" always winning a bid in a certain geographical area for a particular service, or in a fixed rotation with other bidders.
6. A certain company appears to be bidding substantially higher on some bids than on other bids, with no logical cost difference to account for the difference.
7. A successful bidder repeatedly subcontracts work to companies that submitted higher bids on the same projects.

8. There are irregularities (*e.g.*, identical calculation errors) in the physical appearance of the proposals, or in the method of their submission (*e.g.*, use of identical forms or stationery), suggesting that competitors had copies, discussed, or planned one another's bids or proposals. If the bids are obtained by mail, there are similarities of postmark or post metering machine marks.

9. Two or more competitors file a "joint bid" even though at least one of the competitors could have bid on its own.

10. Competitors meet as a group to exchange any form of price information among themselves. (When this occurs among sellers in concentrated markets [markets with few sellers], it is suspicious. Note that such exchange may take quite subtle forms, such as public discussion of the "right" price.)

11. A bidder appears in person to present his bid and also submits the bid (or bond) of a competitor.

12. Competitors submit identical bids or frequently change prices at about the same time and to the same extent.

13. Bid prices appear to drop whenever a new or infrequent bidder submits a bid.

14. Competitors regularly socialize or appear to hold meetings, or otherwise get together in the vicinity of procurement offices shortly before bid filing deadlines.

15. Local competitors are bidding higher prices for local delivery than for delivery to points farther away. (This may indicate rigged prices in the local market.)

B. <u>SUSPICIOUS STATEMENTS</u>

Sometimes, statements made by marketing representatives of suppliers suggest that price fixing is afoot. Example of such statements, and other representations that are suspicious and may be indicative of price fixing, include:

a. Any reference to "Association price schedules," "industry price schedules," "industry suggested prices," "industry-wide" or "market-wide" pricing.

b. Justification for the price or terms offered "because they follow industry (or industry leaders) pricing or terms," or "follow (a named competitor's) pricing or terms."

c. Any reference to "industry self-regulation," etc., such as justification for price or terms "because they conform to (or further) the industry's "guidelines" or "standards."

d. Any references that the representative's company has been meeting with its competitors for whatever reason.

e. Justification for price or terms "because our suppliers, etc., require it" or "because our competitors, etc., charge about the same," or "we all do it."

Statements by marketing representatives or in company promotional materials may also suggest the existence of agreements among competitors to divide territories or customers. (This is also known as market allocation.) Highly suspicious examples are:

a. Any references that the representative's company "does not sell in that area," or that "only a particular firm sells in that area," or "deals with that business."

b. Statements to the effect that such and such salesman (of a competitor) should not be making particular proposals to you, or should not be calling on you.

c. Statements to the effect that it is a particular vendor's turn to receive a particular job or contract.

Consultations among purchasing agencies that procure the same services or commodities can reveal whether vendors are selling to some agencies, but not to others, or if vendors appear to be limiting their selling to particular or selective units within a given agency. Such behavior may suggest a customer allocation scheme.

C. CONDITIONS FAVORABLE TO COLLUSION

While price fixing can occur in almost any industry, it is most likely to occur in industries where only a few firms compete, and where the products of those firms are similar. The bread, milk, and steel industries are examples. Procurement officials should be sensitive to industry conditions that increase the probability of collusion. Thus:

1. Collusion is more likely to occur if there are fewer sellers. The fewer the sellers, the easier it is for them to get together and agree on prices. Collusion may also occur when the number of firms is fairly large, but there are a small group of major sellers and the rest are "fringe" sellers who control only a small fraction of the market.
2. The probability of collusion increases if the product cannot easily be substituted for another product. The gains from colluding will be high if the product has few, if any, good substitutes.

3. The more standardized a product is, the easier it is for competing firms to reach agreement on a common price structure. It is much harder to agree on such forms of competition such a quality or service.

D. COLLECTING RELEVANT INFORMATION

Certain information and types of documents are especially useful to agency investigators pursuing antitrust violations and to prosecutors at the Department of Justice. This list includes the documents and information that will be useful if a Justice Department investigation begins.

1. Information

(a) Indicate the agency's annual dollar value of purchases of the item in each of the three calendar or fiscal years (depending on how you keep the data) proceeding the year in which you received the suspect bids.

(b) State whether the pattern of bidding in the three year period preceding the receipt of the suspect bids appears to indicate bid rigging, bid rotation, sharing of the business, collusive bidding, or any other form of joint action. Explain.[3] **As this**

[3] In order to detect bid rotations, accurate records of bid tabulations over a period of time are essential. It is most helpful if you computerize the following data for each contract let: (1) The identity of each firm that received an invitation to bid, (2) the identity of a firm that submitted a bid, along with the amount of the bid and the variance between the bid and the agency's estimate, if there is one, and (3) the identity of the winning bidder. A typical procurement action should appear on a computer printout as follows:

Project:_____ Date:
Estimate $100,000

Co. Winner **Bid**

information is collected, "suspect projects" can be identifies. You will be able to focus on the most promising projects, *i.e.*, those where there are few bidders and the bids seem suspiciously high in relation to the estimate or prior bids. You will also be able to identify the companies that consistently bid on particular contracts and determine whether they are taking turns being the low bidder.

(c) If there are any known financial, personal, or other relationships among any of the suspect bidders, describe them.

(d) Indicate whether the Government's specifications are such that only one or a limited number of potential bidders are capable of meeting them.

(e) If there are any known manufacturers or suppliers of the items who consistently avoid bidding on Government contracts, identify them and indicate whether the procurement agency knows why these firms do not seek Government business.

(f) Determine whether one bidder is uniformly low on bids to a particular awarding authority, on particular items, or in particular geographic areas. (If the pattern cannot be explained in economic terms, there may be an unlawful allocation of customers or territories.)

		From Estimate
A.	**Co.**	
	$110,000	**+10%**
B.	**Co.**	
	$120,000	**+20%**
C.	**Co.**	
	$130,000	**+30%**

(g) Determine whether each bidder enjoyed a constant percentage of the total business over a period of years. (If so, there may be an unlawful division of total business.)

(h) Indicate whether or not the price bid by the suspect bidders are identical to their published list prices. If the prices quoted by the suspect bidders are not their published list prices, state whether the bids appears to have been derived by the application of a uniform "Government discount" from list prices, or by some other method of computation. If available, furnish photostatic copies of suspect bidders' and other bidders' standard price lists.

(i) Indicate whether there appears to be a territorial division by competitors. One way to do this is to assign each competitor a different color. Then, using a map of the purchasing area, appropriately colored pins (or tabs) can be inserted for each location where a contract is awarded. If clusters of the same color are found throughout the area, there may be an illegal allocation of territories.

2. <u>Documents</u>

(a) A copy of the invitation for bids, and any amendments thereto, and a list of all parties invited to bid.

(b) An abstract of all bids received for each item covered by the bid invitation, showing for each such bid:

(i) The unit and total price bid.

(ii) The net price to the Government after discounts and allowances for transportation, or other costs.

(iii) The destination of shipments, and whether the price quoted includes or excludes the cost of transportation to destination.

(iv.) The identity of the successful bidder; where identical low bids were submitted by several bidders, indicate how the award was made.

(c) Copies of documents filed by suspect bidders as part of the bid submission or obtained by the procuring agency, such as the following:

(i) Evidence of financial or other ties between suspect bidders (as revealed by Dun and Bradstreet or other reliable financial reports).

(ii) Copies of reports containing the finding of any special investigation conducted by the procurement agency concerning the bids at issue including inquiries related to any bid protests.

(iii) Copies of all correspondence between the procurement agency and the suspect bidders.

(iv) Copies of any certificates of independent price determination or not-collusion submitted by the bidders.[4]

[4]Such documents are need to determine if an additional federal crime of making false statements to the government under 18 U.S.C. § 1001 has been committed.

(v) You should save the original bids, envelopes, and affidavits of non-collusion for all bidders. In addition, you should save the log recording government mailings to the bidders, including notice of awards, checks and notices to proceed.[5] These will be important as evidence in the event any action is taken.

VII. ENCOURAGING COMPETITION

Procurement officers can assist in the enforcement of the antitrust laws not only by playing an active role in the detection of collusive bidding, but also by taking positive steps to stimulate competition and prevent collusive behavior. This section discusses some of the procedures that can be established to discourage anticompetitive activity.

A. EXPAND LIST OF BIDDERS

It is much more difficult for a large group of competitors to collude than for a small group. To reduce the ability of conspirators to coordinate illegal activities, buyers should solicit as many reliable sources as economically possible. As the number of bidders increases, the probability of successful collusive bidding decreases. Soliciting numerous suppliers will not necessarily prevent a conspiracy, but it can reduce the effectiveness of a conspiracy by providing a larger competitive base. While there is no magic number of bidders above which collusion does not occur, past experience suggests that collusion is more likely to arise where there are ten or fewer competitors.

B. CONSOLIDATE PURCHASES

[5]This documentation will determine whether the federal crime of mail fraud (18 U.S.C. § 1341) was committed.

Another defensive tactic available to agencies is to combine orders. The existence of a large number of contract opportunities facilitates collusion among sellers. When buyers are numerous, and each purchases only a small amount, sellers have less incentive to grant price cuts. Consolidation of purchases tends to increase the value of winning the bid. A firm, even if part of a conspiracy, may be tempted to cheat and take the prize.

C. AWARDING THE BIDS

Not all identical bids are the result of a price fixing conspiracy. However, procurement officers should not inadvertently encourage tie bids by assuring identical bidders an equal or reasonable share of the buyer's business. From a seller's standpoint it may be better to share business equally with other suppliers at a significantly higher price than to have an uncertain share of the business at lower competitive prices. Thus, in a tie bid situation, agencies should consider reletting the contract, or some way to award the bid to one of the tied bidders. A lottery system of awarding contracts should not be used.

D. KEEP THE PROCESS SECRET

You should consider not publicly disclosing the identity of proposal holders or bidders. This will help prevent competitors from knowing who to contact. You should also consider not publicly disclosing the government's estimate so that bidders do not have an incentive to use that estimate as the floor for their bids.

VIII. SOME OVERALL STEPS TO TAKE TO DETECT AND DETER COLLUSION

All buyers, and in particular federal agencies, have a tremendous stake in detecting and deterring price fixing. In fiscal 1999, federal procurement alone amounted to over $198 billion of which about $125 billion was competitively let or a follow-up to competed action. Without

doubt, some contracts are the subjects of collusion like bid rigging. It is up to procurement personnel to understand the applicable law, to limit opportunities for collusion and to seek out evidence of violations for prosecution. If the vendor community realizes that you mean business in antitrust enforcement, the dollars saved can be spent on more worthwhile projects. This section summarizes programs that a buying authority should consider adopting as a matter of policy:

1. Assure that procurement and contract personnel, auditors and investigators understand the elements of collusion, such as bid rigging and market allocation. Provide instruction on how to detect collusion, etc. (The Antitrust Division can assist you.) Stress the importance (to the agency and to the taxpayer) of preventing and detecting collusion. In short, THINK ANTITRUST.

2. Have procurement records, *e.g.*, bid lists, abstracts, awards, readily available. Looking at a single contract is not enough because records of past bids are needed to determine if a pattern of allocation or rotation is present. Data collection forms should be employed, with the raw information subsequently compiled and, where feasible, programmed for storage in a computer. This makes routine analysis simple and keeps you aware of patterns. It may also be prudent to advise the bidders that you conduct this type of analysis periodically.

3. Reports of suspected collusion (base upon a bid analysis, an audit, a complaint from other competitors, or statements by persons who appear knowledgeable, *e.g.*, former employees) should be communicated within the agency and to the Antitrust Division along established, readily available channels. If other federal violations also appear to be present, *e.g.*, false statement (18 U.S.C. § 1001); mail fraud (18 U.S.C. § 1341) or conspiracy to fraud (18 U.S.C. § 371), these offenses can also be prosecuted by the Antitrust Division if they are related to the

types of collusion described here. If it does not, the Antitrust Division will refer it to an appropriate U.S. Attorney. If the Antitrust Division is contacted promptly, a determination can be made whether:

(a) additional facts are needed;

(b) a formal Antitrust Division investigation should be commenced. If so, an appropriate Antitrust Division section or field office will be assigned to work with the agency and its investigators to develop the case; or

(c) the allegations do not suggest an antitrust violation. If other federal violations appear to be present, the agency will be advised to contact an appropriate U.S. Attorney or the Criminal Division within the Department of Justice.

4. Encourage informal communications between agency personnel (*e.g.*, procurement, audit, investigative and legal staff) and Antitrust Division personnel whenever a potential bid rigging situation is encountered.

5. The agency should consider rewarding agency employees responsible for detecting and developing information that may result in antitrust or fraud prosecutions.

IX. CONCLUSION

The Antitrust Division of the Department of Justice is interested to hear from you with your comments and suggestions on how to detect and prevent collusive and fraudulent conduct and help to maintain a vital and competitive marketplace in all areas of commerce. In the event you would like to discuss matters raised in this paper, please contact our Washington headquarters or one of our conveniently located field offices. The names, addresses, and telephone numbers are listed on the next page. If you have comments on this paper, please

contact Peter H. Goldberg at the Department of Justice, Antitrust Division, National Criminal Enforcement Section, 1401 H Street, NW, Suite 3700, Washington, D.C. 20530; or Peter.Goldberg@usdoj.gov; or by telephone at (202) 307-5784.

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CHAPTER 6

CRIMINAL REMEDIES AND CRIMINAL LAW UPDATE

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I. INTRODUCTION

A. Criminal prosecution of procurement fraud remains the Federal Government's most powerful and important remedy.

B. For an individual defendant, imprisionment is of dreater significance thatn any other possible sanction. The possible impact of collateral proceedings following a criminal indictment or conviction may be of greater significance for an organization than the actual criminal sanctions.

1. Suspension or debarment from government contracting and other government business.

2. Treble damages and civil penalties under the civil False Claims Act.

3. Class action shareholder suits and loss of market confidence and value.

4. Denial, suspension or loss of export licenses.

C. Department of Justice United States Attorney's Offices (USAOs).

1. USAOs have primary responsibility for prosecuting violations of federal criminal law.

2. 93 USAOs throughout the 50 states, Guam, Marianas, Puerto Rico, and the U.S. Virgin Islands.

3. Each United States attorney is a presidential appointee and is the principal federal law enforcement officer in his or her district.

4. Prosecutions are the responsibility of Assistant United States Attorneys (AUSAs).

D. Department of Justice Criminal Division, Washington, D.C. (http://www.usdoj.gov)

1. Responsible for developing, implementing, and coordinating federal criminal law policy issues.

2. Criminal Division attorneys prosecute selected cases.

3. Fraud Section is part of the Criminal Division in Washington, D.C.

a. Responsible for criminal law policy issues related to procurement fraud.

b. Acts as clearing house of information for AUSAs and investigative agencies regarding procurement fraud prosecutions.

c. Prosecutes procurement fraud cases referred directly by investigators, when requested by USAOs, or when USAOs are recused.

d. In coordination with the DOD IG, reviews, determines admissibility, and supervises verification investigations of

voluntary disclosures submitted under the DOD IG Voluntary Disclosure Program.

II. CONVINCING AN AUSA TO PROSECUTE A PROCUREMENT FRAUD CASE.

A. Referring agency or criminal investigators must convince an AUSA that a procurement fraud case warrants prosecution. This is not always an easy task.

1. Procurement fraud is not the first priority in many USAOs. Health care fraud is frequently a higher white collar priority. Procurement fraud referrals must compete with other white collar priorities such as telemarketing fraud, financial institution fraud, and public corruption.

2. Some USAOs lack AUSAs with procurement fraud experience and are understandanbly reluctant to commit significant resources to the development of a complex, document intensive case with uncertian prosectuion potentail.

a. Large offices such as the Central District of California, Eastern District of Pennsylvania, and the Eastern District of Virginia are exceptions, but may still have only a limited number of AUSAs available to consider procurement fraud cases.

b. Some USAOs have a military judge advocate or an agency attorney detailed as a Special AUSA who may be more available to support a procurement fraud case.

3. USAO may have a dollar amount loss threshold for procurement cases higher than the loss typical for fraud at camp, post or installation level.

4. Health or safety issues may cause an AUSA to accept for prosecution a case without a large monetary loss.

5. The type of case and evidence available are important considerations for any AUSA.

a. Resource question - how much time and effort will be required to make the case and what is the likelihood of success?

b. Jury appeal.

(1) Complex or difficult cases might be declined in the absence of strong evidence of criminal intent:

(a) Complex IR&D issues.

(b) Defective pricing.

(c) Product substitution or defective testing cases involving deliverables that work or disputed specifications.

(d) Cost mischarging cases involving complicated overhead or labor rate issues.

(2) Government complicity or bungling reduces prosecution potential.

(a) Government employees (e.g., COTRs, QARs, program managers) were aware of conduct but did nothing or implicitly condoned it.

(b) Formal or informal waivers by government employees.

(c) "Form, fit & function." Deliverable does not meet letter of applicable specifications but works well or is consistent with current industry standard.

III. CONDUCTING THE INVESTIGATION.

A. Inspector General Subpoenas. 5 U.S.C. App. § 6(a)(4).

1. Broad subpoena power for documents relevant to the investigation of waste, fraud, and abuse in an agency program.

2. No power to compel testimony.

3. Production of responsive documents is often slow and compelling production of originals is problematic.

4. Enforcement of IG subpoenas is the responsibility of the U.S. Department of Justice Civil Division through a "show cause" hearing in U.S. District Court in the district in which the subpoenas are served.

5. Information collected may be shared with other government investigators or agencies and may be used for civil or administrative actions. IG subpoenas are the subpoena of choice for civil False Claims Act investigations.

B. Grand Jury Subpoenas.

1. Grand jury subpoenas can compel production of documents and testimony.

2. In many circumstances, Fed.R.Crim.P 6(e) secrecy requirements preclude the use of evidence obtained by the grand jury in administrative or civil matters except with a court order.

3. Enforcement of grand jury subpoenas is typically handled by the AUSA responsible for the investigation for which the subpoena was issued by filing a contempt motion before the U.S. District Court supervising or responsible for the grand jury.

C. Search Warrants. Fed.R.Crim.P. 41.

1. Search warrants afford no notice and prevent destruction or withholding of evidence.

2. Search warrants can be executed quickly without a lot of time-consuming motions.

3. Evidence seized can support civil, administrative or contractual actions.

4. Search may cause "panic effect" and encourage contractor employee cooperation with investigators.

5. Successful suppression motions based on defects in the search warrant or search procedure may taint entire investigation.

D. Electronic Surveillance under "Title III." 18 U.S.C. §§ 2510-2521.

1. Wiretaps are rarely used in procurement fraud investigations, although the Ill Wind prosecutions in the late 1980's and early 1990's proved their effectiveness. Application for and operation of wiretaps require a substantial dedication of USAO and FBI resources, which are typically forthcoming only in major cases with a high likelihood of success.

2. By DOJ Policy, video surveillance is treated as if it fell under Title III, even if no voice intecept is done.

3. More common are consensually monitored telephone conversations or use of body wires by cooperating witnesses, particularly qui tam relators. Defense Criminal Investigative Service and military investigative organizations must obtain DOD IG or secretarial-level consent prior to consensual tape recordings.

E. Undercover operations and stings have been used successfully in a number of procurement fraud prosecutions, particularly in the fastener and aviation parts industries.

IV. CRIMINAL STATUTES AND ELEMENTS OF PROOF.

The following statutes are those most commonly utilized in procurement fraud prosecutions. Unless specifically noted, the maximum punishment for federal felonies for

individuals is a fine of $250,000 and imprisonment for five years and for organizations is a fine of $500,000. 18 U.S.C. § 3571. The United States Sentencing Guidelines control the actual sentence imposed.

A. False Statement. 18 U.S.C. § 1001.

1. Prohibits the knowing making or use of a false statement, representation or writing, or the concealment or cover up by any trick, scheme, or device, of a material fact, in relation to a matter within the jurisdiction of any department or agency of the United States.

2. Elements:

a. Defendant makes or uses a false statement or writing. Statement can be oral or written, sworn or unsworn, signed or unsigned.

b. False statement must be made knowingly and willfully, i.e., with knowledge that statement was false.

c. Statement must be made in relation to a matter within the jurisdiction of a department or agency of the United States, that is, the executive, judicial or legislative branch department or agency had authority to act on the statement.

d. Statement was material, i.e., statement could have influenced the outcome of the department or agency decision or action. There is no need that the department or agency actually acted on statement or even knew of statement. Materiality is a jury question. United States v. Gaudin, 515 U.S. 506 (1995)(overturning substantial lower court precedent).

3. Death of the "Exculpatory No" Doctrine. In Brogan v. United States, 118 S.Ct. 805 (1998), the Supreme Court killed the "exculpatory no" doctrine previously recognized by a number of circuit courts. Under the

judicially created doctrine, false statements consisting of a simple denial of one's own wrongdoing (and in some jurisdictions the denial of any individual element of a crime, any subset of elements or of material facts that might establish an element or elements) were excluded from the scope of 18 U.S.C. § 1001.

4. 18 U.S.C. § 1001 was substantially revised in 1996 by the False Statements Accountability Act of 1996, P.L. 104-292, 110 Stat. 3459, in response to Hubbard v. United States, 514 U.S. 695 (1995), which held that section 1001 did not apply to the judicial branch, and by implication the legislative branch of the Federal Government. The revised statute specifically provides that section 1001 applies to statements made to each branch of government. However, the revised statute explicitly incorporates the judicial and legislative function exceptions that were settled law prior to the Hubbard decision. The judicial function exception exempts from section 1001's application those representations made by a party or party's counsel to a judge during a judicial proceeding, so as to avoid any chilling effect upon the adversarial process. The legislative function exception exempts from section 1001's application those communications made to or before Congress and which do not constitute administrative filings and which are not furnished in connection with a duly authorized investigation.

B. False Claim. 18 U.S.C. § 287.

1. Prohibits the knowing making or presentation of a false, fictitious, or fraudulent claim to a department or agency of the United States.

2. Elements:

a. A claim exists, i.e., any attempt to secure money or property.

b. Making or presentation of claim to United States.

c. Knowledge that the claim is false, fictitious or fraudulent.

C. Conspiracy. 18 U.S.C. § 371.

1. Prohibits any agreement between two or more persons to defraud the United States or to commit any offense against the United States.

2. Elements:

a. Agreement between two or more persons to accomplish one or both of the following objects:

(1) To commit a criminal offense; or

(2) To defraud the United States by cheating the government out of property or money or to impair, impede, interfere with or obstruct one of the government's lawful functions, such as procurement, by deceit, trickery or other dishonest means.

b. Defendant must be aware of conspiracy, intend to participate in it, and actually participate.

c. Commission of an overt act in furtherance of the conspiracy by at least one of the co-conspirators. Overt act need not itself be unlawful.

3. Applications.

a. Proof of conspiracy makes admissible against all co-conspirators the statements of each made in furtherance of the conspiracy (although a conspiracy need not be charged). Fed.R.Evid. 801(d)(2)(E).

b. As a continuing offense, the statute of limitations runs from the last overt act thus reaching earlier activities which otherwise may be outside the statute of limitations.

D. Conspiracy to Make False Claims. 18 U.S.C. § 286.

1. Prohibits any agreement to defraud the United States or any federal agency by obtaining payment of any false, fictitious or fraudulent claim.

2. Elements:

a. Agreement between two or more persons to defraud the United States or a federal agency.

b. Attempt to obtain or obtaining of payment by submission of a false claim pursuant to the agreement.

3. Same conspiracy may be charged as either a violation of the general conspiracy statute, 18 U.S.C. § 371, or as a violation of 18 U.S.C. § 286, or both. United States v. Lanier, 920 F.2d 887 (11th Cir.), cert. denied, 502 U.S. 872 (1991).

E. Mail and Wire Fraud. 18 U.S.C. §§ 1341 and 1343.

1. Mail Fraud (18 U.S.C. § 1341) prohibits use of the mails (or use of private or commercial interstate carrier) and Wire Fraud (18 U.S.C. § 1343) prohibits use of the interstate wires to attempt to execute or to execute a scheme to defraud or to obtain money by false pretenses or representations.

2. Elements:

   a. Existence of a scheme or artifice to defraud or to obtain money by false pretenses or representations.

   b. Intent to defraud by knowing participation in the scheme or artifice

   c. Use of the mails (or private or commercial interstate carrier such as Federal Express) or interstate wires in furtherance of the scheme or artifice to defraud or to obtain money by false pretenses or representations.

3. Applications.

   a. Need not show that defendant intended that mails, commercial carrier, or wires be used. Sufficient if defendant knew that a mailing or use of the wires would follow in the ordinary course of business or if such use could be reasonably foreseen.

   b. Mailing or material provided to commercial carrier or use of wires need not itself be false or illegal.

   c. Success or failure of scheme or artifice is not material and there is no need to prove an actual loss.

d. Mail and wire fraud statutes reach a scheme or artifice to defraud the United States by cheating the government out of property or money or to impair, impede, interfere with or obstruct one of the government's lawful functions, such as procurement, by deceit, trickery or other dishonest means.

4. There is a split among the circuits whether materiality is an element of mail fraud, 18 U.S.C. § 1341, or wire fraud, 18 U.S.C. § 1343. Materiality is not an element. United States v. Neder, 136 F.3d 1459 (11th Cir. 1998); United States v. Uchimura, 125 F.3d 1282 (9th Cir. 1997). Materiality is an element. United States v. Klausner, 80 F.3d. 55 (2d Cir. 1996).

F. Major Procurement Fraud. 18 U.S.C. § 1031.

1. Prohibits procurement fraud involving contracts or subcontracts with the United States valued at $1 million or more.

2. Elements:

a. Defendant executed or attempted to execute a scheme or artifice with the intent to defraud the United States or to obtain money or property from the United States by false pretenses or representations.

b. Defendant did so knowingly.

c. Defendant attempted to execute or executed the scheme or artifice in a procurement of property or services as a prime contractor with the United States or as a subcontractor or supplier on a contract in which there was a prime contract with the United States.

d. The value of the contract or subcontract was $1 million or more.

3. Applications.

a. Similar to mail and wire fraud statutes except that the acts in execution of the scheme or artifice are not limited to the use of the mails, commercial carrier, or interstate wires. Each act in execution of the scheme is a separate offense. United States v. Sain, 141 F.3d 463 (3d Cir. 1998); United States v. Frequency Electronics, 862 F.Supp. 834 (E.D.N.Y. 1994); United States v. Broderson, No. 93-1177 (JM)(E.D.N.Y. 1994), 1994 U.S. Dist. LEXIS 12982; contra, United States v. Wiehl, No. 94-CR-443 (N.D.N.Y. Dec. 7, 1994), 1995 U.S. Dist. LEXIS 15999. To determine if an action is a separate execution of the scheme, the court will look to whether the actions are substantively and chronologically independent from the overall scheme (e.g., a separate effort to obtain money). Sain, supra.

b. The circuits are split whether the $1 million jurisdictional amount is determined by reference only to the value of the contract which is the subject of the fraud (United States v. Nadi, 996 F.2d 548 (2d Cir. 1993)) or by reference to any related prime contract, subcontract at any tier or constituent part of the procurement (United States v. Brooks, 111 F.3d 365 (4th Cir. 1997)). See also, United States v. Sain, 141 F.3d 463 (3d Cir. 1998)(fraud in connection with contract modifications with a value less than $1 million was within the scope of 18 U.S.C. § 1031 where the total contract value exceeded $1 million; no need to resolve split between 2d and 4th circuits).

c. Statute significantly escalates maximum fines if the loss to the government is greater than $500,000 or the offense involves a conscious or reckless risk of serious personal injury.

d. Seven year statute of limitations.

e. 10-year maximum term of imprisonment.

G. Obstruction of Federal Audit. 18 U.S.C. § 1516.

1. Prohibits obstruction of a federal auditor in the performance of official duties.

2. Elements:

a. The federal auditor was in the performance of official duties.

b. The official duties must relate to a person or organization receiving in excess of $100,000, directly or indirectly, from the United States in any one-year period under a contract or subcontract.

c. Defendant must know that the auditor was in the performance of official duties.

d. Defendant must endeavor to influence, obstruct, or impede the auditor in the performance of his official duties.

e. Defendant must act willfully, with the intent to deceive or to defraud the United States.

3. Applications.

a. The statute broadly defines "federal auditor" to include quality assurance inspectors as well as traditional auditors.

b. The government need not prove that the auditor was actually influenced, obstructed or impeded.

H. Bribery of Public Officials. 18 U.S.C. § 201(b)(1-2).

1. Prohibits corruptly offering or giving anything of value to any officer or employee of the United States (§ 201(b)(1)) or the corrupt solicitation or receipt by such officer or employee of anything of value (§ 201(b)(2)).

2. Elements:

a. Giving, offering, or promising to a public official, or the demand or receipt by a public official, of:

b. Anything of value

c. With intent to:

(1) Influence any official act; or

(2) Commit a fraud on the United States; or

(3) Do or omit to do an act in violation of the officer's or official's duty.

3. Applications

a. A quid pro quo must be proved.

b. No defense if public official does not have authority to act or would have acted in the same fashion in the absence of the bribe.

c. 15-year maximum term of imprisonment and prohibition against government employment.

I. Gratuity to Public Official. 18 U.S.C. § 201(c)(1-2).

1. Prohibits giving, offering, or promising a public officer or official anything of value because of an official act (§ 201(c)(1)), or a public officer or official from seeking, demanding, or receiving anything of value because of an official act.

2. Elements:

a. The giving, offering, or promise to a public official, or the demand, receipt, or acceptance by a public official, of

b. Anything of value

c. For or because of an official act.

3. Applications.

a. A gratuity need not be "corruptly" given or received, i.e., a quid pro quo is not required.

b. Two-year maximum term of imprisonment.

4. The gratuity statute requires some intent to affect or reward official conduct, i.e., the gift must be "for or because of the act." United States v. Sun-Diamond Growers of California, 138 F.3d 961 (D.C. Cir. 1998)(rejecting jury instructions that it is not necessary to show that a payment is intended for a particular matter then pending before the official, it is sufficient if the motivating factor for the payment is just to keep the official happy or to create a better relationship in general with the official). Sun-Diamond implicitly rejects those decisions holding that gifts motivated solely by the recipient's official position may be illegal gratuities. E.g., United States v. Bustamante, 45 F.3d 933 (9th Cir. 1995).

J. Conflicts of Interest.

1. 18 U.S.C. § 207 makes criminal under certain conditions instances where former government employees from certain private activity or employment related to their former official duties.

2. 18 U.S.C. § 208 prohibits a government official from personally or substantially participating in government actions in which he or his immediate family have a financial interest, to include employment negotiations with a contractor.

3. The use of a criminal prosecution for the disposition of conflicts of interest is uncommon, but not unheard of. These violations can be dealt with as misdomeanors or felonies. Typically, administrative disciplinary actions are brought against government employees. Violations can also be dealt with in a civil action with fines up to $50,000 per violation.

K. Anti-Kickback Enforcement Act. 41 U.S.C. §§ 51-58.

1. Prohibits the payment or acceptance, attempts to pay or accept, and the offer or solicitation of a kickback.

2. Elements:

a. In a prime contract with the United States or a subcontract to such a prime contract

b. Defendant provided, attempted to provide, or offered to provide a kickback; or defendant solicited, accepted, or attempted to accept a kickback; or defendant included the amount of any kickback to the price of the prime contract or subcontract.

c. Defendant acted knowingly and willfully.

3. The statute broadly defines a kickback as "any money, fee, commission, credit, gift, gratuity, **thing of value**, or compensation of any kind which is provided, directly or indirectly, to any prime contractor, prime contractor employee, subcontractor, or subcontractor employee for the purpose of improperly obtaining or rewarding favorable treatment in connection with a prime contract or in connection with a subcontract relating to a prime contract."

4. Anti-Kickback Act does not require proof that the defendant intended to obtain government business or that the defendant even knew that his kickback activity related to Federal Government contracts or subcontracts. Kickbacks made at any point in the government procurement process for the purpose of improperly obtaining favorable treatment are prohibited. United States v. Purdy, 144 F.3d 241 (2d Cir. 1998).

L. Theft and Conversion of Government Property. 18 U.S.C. § 641.

1. Prohibits the theft, conversion, or conveyance without authority of government property of a value over $100 for a felony offense or $100 or less for a misdemeanor offense.

2. Elements:

   a. Defendant embezzled, stole, purloined or knowingly converted to his use or the use of another; or without authority sold or conveyed or received and retained

   b. A thing of value

   c. Which was the property of the United States.

3. Application.

   a. Applies to the theft, conversion or unauthorized conveyance of classified information.

   b. 10-year maximum term of imprisonment.

M. Revised Procurement Integrity Act. 41 U.S.C. § 423.

1. Prohibition on Disclosing Procurement Sensitive Information.a. A present or former government official, or person acting for the government;b. Knowingly disclosed contractor bid or proposal information or source selection information before award of a competitive federal agency procurement contract to which the information relates;c. The official or person had access to that information by virtue of his or her office; andd. The official or person acted with the purpose of exchanging the information to receive something of value **or** to obtain or give another party a competitive advantage in the award of a contract.2.

Prohibition on Obtaining Procurement Sensitive Information.a. A person knowingly obtained contractor bid or proposal information or source selection information;b. Before the award of a competitive federal agency procurement contract to which the information relates;c. The person acted with the purpose of exchanging the information to receive something of value or to obtain or give another party a competitive advantage in the award of a contract.3. Source selection information includes any of the following, if not previously disclosed publicly: bid prices or proposed costs or prices submitted in response to a Federal agency solicitation, or lists of those proposed costs or prices; source selection plans; technical evaluations of proposals; cost or price evaluations of proposals; competitive range determinations that identify proposals that have a reasonable chance of being selected for award of a contract; rankings of bids, proposals or competitors; or reports and evaluations of source selection panels, boards, or advisory councils. 1. Prohibition on Disclosing Procurement Sensitive Information.

a. A present or former government official, or person acting for the government;

b. Knowingly disclosed contractor bid or proposal information or source selection information before award of a competitive federal agency procurement contract to which the information relates;

c. The official or person had access to that information by virtue of his or her office; and

d. The official or person acted with the purpose of exchanging the information to receive something of value **or** to obtain or give another party a competitive advantage in the award of a contract.

2. Prohibition on Obtaining Procurement Sensitive Information.

a. A person knowingly obtained contractor bid or proposal information or source selection information;

b. Before the award of a competitive federal agency procurement contract to which the information relates;

c. The person acted with the purpose of exchanging the information to receive something of value or to obtain or give another party a competitive advantage in the award of a contract.

3. Source selection information includes any of the following, if not previously disclosed publicly: bid prices or proposed costs or prices submitted in response to a Federal agency solicitation, or lists of those proposed costs or prices; source selection plans; technical evaluations of proposals; cost or price evaluations of proposals; competitive range determinations that identify proposals that have a reasonable chance of being selected for award of a contract; rankings of bids, proposals or competitors; or reports and evaluations of source selection panels, boards, or advisory councils.

5. Contractor bid or proposal information means any of the following information submitted to a Federal agency as part of or in connection with a bid or proposal to enter into a contract, if not disclosed publicly: cost or pricing data (as defined by 10 U.S.C. § 2306a(h)); indirect costs and direct labor rates; proprietary information about manufacturing processes, operations or techniques marked by the contractor in accordance with applicable law or regulation; or information marked in accordance with FAR § 52.215-12.

6. Penalties. Criminal violations of the statute may result in imprisonment for not more than five years and a fine not to exceed $250,000 for individuals or $500,000 for organizations. Can be disposed of by civil action with a maximum fine of $50,000 per violation.

7. The Procurement Integrity Act also provides that agency officials must report contact regarding non-governmental employment, and futher sets forth a one year post employment ban on compensation. These two sections are not subject to criminal penalties, but can be enforced in a civil action with penalties of up to $50,000 per violation.

N. Money Laundering. 18 U.S.C. §§ 1956 and 1957.

1. Generally prohibit certain financial and other transactions involving the proceeds of predicate crimes called "specified unlawful activities," to include mail and wire fraud.

2. In a procurement fraud case, additional proof for money laundering often involves only the introduction of banking and other financial records.

3. Under the United States Sentencing Guidelines, the base offense level and potential sentencing range are higher for money laundering offenses than for fraud offenses, unless the dollar loss is substantial. Many AUSAs add money laundering counts to a procurement fraud indictment to increase the potential sentence and, as a result, to encourage and to gain leverage in plea negotiations.

O. The Economic Espionage Act. 18 U.S.C. §§ 1831-1839.

1. Effective October 11, 1996, Pub. L. No. 104-294, Title I, § 101(a), 110 Stat. 3488, the Economic Espionage Act is the first Federal statute specifically making criminal the theft of trade secrets.

2. Elements:

a. The defendant stole, or without authorization of the owner or through deception, obtained, received, possessed, copied, duplicated, downloaded, uploaded, transmitted, destroyed or conveyed information;

b. The information was a trade secret;

c. The defendant intended to convert the trade secret to the benefit of someone other than the owner;

d. The defendant knew or intended that the owner of the trade secret would be injured; and

e. The trade secret was related to or was included in a product that was produced or placed in interstate commerce.

3. Application.

a. The term "trade secret" is to be construed broadly, to encompass "all forms and types of financial, business, scientific, technical, economic, or engineering information . . . whether tangible or intangible, and whether or how stored, compiled or memorialized . . . [provided that] the owner thereof has taken reasonable measures to keep such information secret" and "the information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, the public." 18 U.S.C. § 1839. The definition of "trade secret" includes bid estimates and production schedules and reaches circumstances where competitors are "attempting to uncover each other's bid proposals." H.R. Rep. No. 788, 104th Cong., 2d Sess. 9 (1996), reprinted in 1996 U.S.C.C.A.N. 4021, 4023.

b. The Act is much broader than theft, which normally requires the physical removal of property with the intent to deprive the owner of its use. Under the Act, no tangible property need be removed from its owner.

c. Copying and conveying are separate. An individual who had authorization to copy information may violate the Act if he or she conveys it without authorization.

d. Penalties. An individual violating the Act can be fined up to $500,000 and imprisoned for not more than 10 years. A corporation violating the Act can be fined up to $5 million or in an amount twice the value of the gain or loss resulting from the theft of the trade secret, whichever is larger.

e. Forfeiture. The Act provides for criminal forfeiture of any property or proceeds derived from the violation, to include the facilities of an organization at which the violation occurred.

f. The Act requires the approval of the Attorney General, the Deputy Attorney General or the Assistant Attorney General for the Criminal Division prior to the filing of an indictment charging a violation of the Act.

g. Extraterritoriality. The Act specifically applies to conduct outside the United States if the offender is a U.S. citizen or permanent resident or an act in furtherance of the offense was done in the United States.

h. The Act provides no private right of action for a violation.

V. UNITED STATES SENTENCING GUIDELINES (U.S.S.G.).

A. Application to Procurement Fraud Offenses. U.S.S.G. § 2F1.1.

1. U.S.S.G. § 2F1.1(a) assigns a base offense level of six to procurement fraud cases.

2. U.S.S.G. § 2F1.1(b)(1)(A) - (S) is a fraud table which increases the base offense level by increasing amounts based on the monetary loss.

3. U.S.S.G. § 2F1.1(b)(2) provides for a two-level enhancement if the offense conduct involved "more than minimal planning."

4. In procurement fraud cases, the loss is the actual loss to the government or, if the loss did not come about, the expected or intended loss. U.S.S.G. § 2F1.1, comment. (n.7(b)).

5. In procurement fraud cases, the calculation of loss includes reasonably foreseeable consequential damages. For example, in a product substitution case, the government's reasonably foreseeable costs of reprocurement, fixing the defective product, or disposing of the defective product may be added to the total loss figure. U.S.S.G. § 2F1.1, comment. (n.7(c)).

6. If an offense involved the conscious or reckless risk of serious bodily injury, the offense level may be increased by two levels. If the resulting offense level is less than level 13, the offense level may be increased to level 13. U.S.S.G. § 2F1.1(b)(4).

B. Organizational Sentencing Guidelines. U.S.S.G. Chap. 8.

1. Applicable to offense conduct occurring after November 1, 1991.

2. "Corporate Death Penalty." Organizations existing primarily for criminal purposes or by criminal means should have a fine imposed which divests the organization of its net assets. U.S.S.G. § 8C1.1.

3. Restitution and Probation are authorized punishments.

4. A fine is the primary means of punishment. Fines are determined by calculating a base fine using the offense driven calculations applicable to individual defendants. The base fine is then revised upward or downward based on the organization's level of culpability and specified aggravating or mitigating factors (culpability score).

5. Aggravating factors increase the culpability score. They include:

   a. Involvement in the criminal activity by "high level personnel" or pervasive tolerance of the offense throughout the organization by "substantial authority personnel."

   b. Obstruction of justice.

   c. Misconduct similar to misconduct that previously had been the subject of criminal adjudication or two or more civil or administrative adjudications.

   d. Violation of a judicial order or a term of probation.

6. The mitigating factors are applied to reduce the culpability score. These factors go the heart of corporate self-governance. They are:

   a. An effective program to prevent and detect violations of law in place prior to the offense occurring.

      (1) Not applicable if high level official of organization involved in misconduct.

(2) Not applicable if the organization unreasonably delayed reporting the offense to appropriate governmental authorities.

b. Self-reporting of the offense to the appropriate government authority, cooperation with any subsequent government investigation, and acceptance of responsibility for the misconduct.

VI. CORPORATE CRIMINAL LIABILITY.

A. Generally. Corporations are liable for crimes of their employees and agents acting within the scope of their employment with the intent to benefit the corporation. New York Central and Hudson R.R. Co. v. United States, 212 U.S. 481 (1909); United States v. McDonald & Watson Waste Oil Co., 933 F.2d 35, 42 (1st Cir. 1991); United States v. Twentieth Century Fox Film Corp., 882 F.2d 656, 660 (2d Cir. 1989), cert. denied, 493 U.S. 1021 (1990).

B. Employees and Agents.

1. Corporations are liable even for acts of low level employees. United States v. Basic Construction Co., 711 F.2d 570, 572 (4th Cir.), cert. denied, 464 U.S. 956 (1983).

2. Statements of any employee are admissible as admissions against the organization. Fed.R.Evid. 801(d)(2)(D).

C. Scope of Employment.

1. The acts of an employee are within the scope of employment if they are done on behalf of the corporation or for its benefit. United States v. Hilton Hotels, 467 F.2d 1000, 1004 (9th Cir. 1972), cert. denied, 409 U.S. 1125 (1973).

2. "Scope of employment" is broadly interpreted beyond conduct that is actually authorized to conduct within the apparent authority of the employee or agent. Id.

D. Intent to Benefit the Corporation.

1. Must be some evidence that employee acted to benefit the corporation although mixed motive involving personal and corporate benefit is sufficient. United States v. Automated Medical Labs, Inc., 770 F.2d 399, 407 (4th Cir. 1985).

2. A corporation may be held liable for crimes by employees even when committed contrary to express instructions or company policy. United States v. Twentieth Century Fox Film Corp., 882 F.2d 656, 660 (2d Cir. 1989)(company's compliance program, however extensive, does not immunize the corporation from liability when employee acting within scope of authority fails to comply with the law.), cert. denied, 493 U.S. 1021 (1990); but see United States v. Beusch, 596 F.2d 871, 878 (9th Cir. 1979)(compliance policy may be considered in determining whether employee was acting to benefit the corporation.).

E. Collective Knowledge.

1. A corporation's knowledge consists of the collective knowledge of all of its employees, so that a corporation may be convicted even if no single employee had a culpable state of mind. United States v. Bank of New England, 821 F.2d 844, 855 (1st Cir.), cert. denied, 484 U.S. 943 (1987).

2. Collective knowledge cases have limited jury appeal.

VII. CORPORATE SELF-GOVERNANCE.

A. Corporate "self-governance" or "self-policing" involves the implementation by corporate management of a comprehensive and effective compliance program to prevent and detect crimes, as well as mechanisms for voluntarily disclosing to the government misconduct the corporation discovers on its own.

B. Corporations have many incentives for "self-governance."

1. Avoid prosecution by appealing to prosecutorial discretion not to prosecute a good corporate citizen for acts of "rogue" employees or by taking advantage of various DOJ voluntary disclosure and leniency programs.

2. Mitigate penalties under the Organizational Sentencing Guidelines.

3. Demonstrate present responsibility to avoid suspension or debarment.

4. Fulfillment of management's responsibility to shareholders to protect corporate assets by ensuring that the board of directors will receive compliance information in a timely manner as a matter of ordinary operations. In re Caremark International, Inc. Derivative Litigation, 698 A.2d 959 (Del.Ch. 1996).

C. Corporate "self-governance" also involves risks.

1. Risk of prosecution regardless of disclosure and cooperation.

2. Disclosure may expose corporation to civil actions such as wrongful termination lawsuits and shareholder derivative lawsuits.

3. Corporate internal investigations may encourage employees to file qui tam lawsuits against the corporation under the Civil False Claims Act.

4. Disclosures may waive applicable attorney-client and other privileges with respect to information contained in the disclosure, making information available to civil litigants. E.g., Westinghouse Electric Corp. v. The Republic of the Philippines, 951 F.2d 1414 (3d Cir. 1991)(disclosure of Westinghouse's internal investigation report to the SEC and to a grand jury waived the attorney-client privilege and work-product doctrine protections).

5. Internal investigations, employee discipline, and "giving up" individual employees to the government result in morale problems and reduced productivity.

Information for this area not available.

Information for this area not available.

Information for this area not available.

CLAIMS INVOLVING FRAUD:
CONTRACTING OFFICER RESTRICTIONS

I. INTRODUCTION

II. PRIMARY RESTRICTIONS ON AUTHORITY

A. THE CONTRACT DISPUTES ACT

Section 605(a)

1. "The authority of this section shall not extend to a claim or dispute for penalties or forfeitures prescribed by statute or regulation which another federal agency is specifically authorized to administer, settle, or determine."

This exclusionary language included:

(a) Claims falling under the CDA's anti-fraud provision, 41 U.S.C. 604.

Martin J. Simko Const., Inc. v. United States, 852 F.2d 540, 545 (Fed. Cir. 1988) ("Section 604 . . . was never intended to be within the purview of the CO."); Appeal of TDC Management Corp., Dkt. No. 1802; 90-1 BCA P 22,627 (October 25, 1989) (CO has no authority to issue a decision setting forth a government claim under section 604)

(b) False Claims Act (FCA) disputes and claims.

Martin J. Simko Const., Inc., 852 F.2d at 547-8.

2. "This section shall not authorize any agency head to settle, compromise, pay, or otherwise adjust any claim involving fraud."

"Agency head" includes their subordinate contracting officers. United States v. United Technologies Corp., No. 5:92-CV-375 (EBB), 1996 U.S. Dist. LEXIS 17398 (D. Conn. October 11, 1996).

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B. THE FEDERAL ACQUISITION REGULATIONS (FAR)

1. FAR 33.210

"The authority to decide or resolve claims does not extend to-- . . . (b) The settlement, compromise, payment or adjustment of any claim involving fraud."

NOTE: FAR 33.210 "interprets [§ 605(a)] and admonishes the CO not 'to decide or settle . . . claims arising under or relating to a contract subject to the [CDA].'" Medina Const., Ltd. V. United States, 43 Fed. Cl. 537, 549 n.11 (1999).

2. FAR 49.106

"If the TCO suspects fraud or other criminal conduct related to the settlement of a terminated contract, the TCO shall discontinue negotiations and report the facts under agency procedures."

C. DEPARTMENT OF JUSTICE LITIGATION AUTHORITY

1. 28 U.S.C. 516

"Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party, or is interested, and securing evidence therefor, is reserved to officers of the Department of Justice, under the direction of the Attorney General."

2. Executive Order 6166 (June 10, 1933)

"As to any case referred to the Department of Justice for prosecution or defense in the courts, the function of decision whether and in what manner to prosecute, or to defend, or to compromise, or to appeal, or to abandon prosecution or defense, now exercised by any agency or officer, is transferred to the Department of Justice."

3. Triggering Event

"Pending" litigation. Hughes Aircraft Co. v. United States, 534 F.2d 889 (1976).

"Litigation becomes pending upon the filing of a complaint with the court." Ervin And Assoc., Inc. v. United States, 44 Fed. Cl. 646, 654 (1999).

4. Effect On A Contracting Officer

Divests the CO "of any authority to rule on the claim." Ervin & Assoc., 44 Fed. Cl. at 654.

CO may not issue a final decision on the claim. Case, Inc. v. United states, 88 F.3d 1004 (Fed. Cir. 1996).

CO "lacks jurisdiction to render a decision on the same claim." Johnson Controls World Services, Inc. v. United States, 43 Fed. Cl. 506, 510 (1999).

CO may not "act in the matter." Medina Const. Ltd v. United states, 43 Fed. Cl. 537, 552 (1999).

III. DEFINITIONAL ISSUES

A. WHEN DOES THE CLAIM INVOLVE FRAUD IN ORDER TO TRIGGER 41 U.S.C. 605(a)/FAR 33.210(b)?

1. During An Ongoing Investigation

Medina Const., Inc., 43 Fed. Cl. at 550.

2. Possibly As Early As When Fraud Is First "Suspected."

See UMC Elec. Co. v. United States, 45 Fed. Cl. 507, 509 (1999), aff'd 249 F.3d 1337 (Fed. Cir. 2001); Medina Const., 43 Fed. Cl. at 555; FAR 49.106.

B. HOW FAR DOES SETTLING, COMPROMISING, ADJUSTING EXTEND?

1. Synonymous With "Decide," "Resolve," "Adjudicate," "Determine," Etc.

UMC Elec. Co., 45 Fed. Cl. at 509 (CO without authority to "determine" fraud); Medina Const., 43 Fed. Cl. at 549 n.11 ("CO not 'to decide or settle . . . .'"); United States v. United Technologies Corp., 2000 Dist. LEXIS 6219 (Contracting agency may not "consider or resolve" fraud); TDC Mgmt. Corp., 1989 DOT BCA LEXIS 26 (CO cannot make fraud determinations).

2. "Compromise" probably does not extend to actions that would undermine the litigation.

C. WHAT IS THE CLAIM?

1. FCA: very broad definition of a claim

   "any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the United States Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded." 31 U.S.C. § 3729.

2. CDA: claim not defined, relies on FAR 33.201's claim definition.

3. PROBLEM: FAR 33.201 purports to define a claim for purposes of FAR 33.210(b)

-Routine Request For Payment:	CDA-No	FCA-Yes
-Uncertified Claims Over $100,000:	CDA-No	FCA-Yes

IV. REOCCURING FACTUAL SCENARIOS

1. Can A CO Determine Whether Fraud Exists?

   NO: UMC Elec. Co., 45 Fed. Cl. at 509; United States Catridge Co., 78 F. Supp. at 83; TDC Mgmt. Corp., 1989 DOT BCA LEXIS 26.

2. After DOJ Declines, Can The CO Resolve The Claim Involving Fraud?

   (a) NOT during an ongoing investigation. Medina Const., 43 Fed. Cl. at 550.

   (b) NOT if the agents end the investigation with a finding of fraud. 41 U.S.C. 605(a); FAR 33.210(b).

   (c) PROBABLY if DOJ determines no fraud exists (rare).

3. What Are The CO's Potential Options, if DOJ Declines But The Agents Find Fraud?

   (a) Have DOJ "Bless" The Contract Action/Resolution?

   -DOJ technically compromising claim? (Recommended)

   (b) Agency "Reevaluates" Their Fraud Determination?

   -What if DOJ later wants to plead fraud?

   -Why are we really changing our mind?

   (c) CO/Agency Moves Forward Unilaterally?

   -acting ultra vires?

   -CO final decision invalid?

NOTE: "A contracting officer's final decision is invalid when the contracting officer lacked authority to issue it." Case, Inc. v. U.S., 88 F.3d 1004, 1009 (Fed. Cir. 1996).

Further, "an invalid final contracting officer's decision may not serve as the basis for a CDA action." Id.

If the CO lacked authority to issue a final decision, "there can be no valid deemed denial of the claim . . . ." Id.

V. CONCLUSION

FISCAL ISSUES IN PROCUREMENT FRAUD

I. INTRODUCTION

II. THE MISCELLANEOUS RECEIPTS STATUTE

Requirement To Return Money To The Treasury

The Miscellaneous Receipts Statute (MRS), 31 U.S.C. 3302, requires that all funds received on behalf of the United states be deposited in the general fund of the U.S. Treasury. Specifically, the MRS provides: "an official or agent of the Government receiving money from the Government from any source shall deposit the money in the Treasury as soon as practicable without deduction for any charge or claim." 31 U.S.C. 3302(b).

MRS applies to "money from the Government *from any source* . . . [t]he original source of the money—whether from private parties or the government—is thus irrelevant." SATO v. DOD, 87 F.3d 1356, 1362 (D.C. Cir. 1996) (emphasis in original).

Improper obligation and expenditure of such monies constitutes an illegal augmentation of an agency's appropriated funds. Security Exchange commission—retention of Rebate Resulting From Participation in Energy Savings Program, B-265734, 1996 U.S. Comp. Gen. LEXIS 82 (Feb. 13, 1996), at * 4.

III. EXCEPTIONS

A. Applies Only To The Receipt Of Money

1. Not applicable to agency receipt of goods or services. Bureau of Alcohol, Tobacco, and Firearms – Augmentation of Appropriations – Replacement of Autos By Negligent Third Parties, B-226004, 67 Comp. Gen. 510 (July 12, 1988).

2. Even if money could have been obtained. ATF, supra.

3. No offset required. ATF, supra (Receipt of goods or services does not require an "offsetting transfer from current appropriations to miscellaneous receipts.").

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B. Statutory Authority To Retain Money The Agency Collects

"However, when an agency is specifically authorized by statute to retain outside moneys it receives, the general rule of the miscellaneous receipts statute does not control." Availability of Receipts From Synthetic Fuels Project, B-247644, 72 Comp. Gen. 164 (April 9, 1993) (Energy Security Act).

Examples:

1. Criminal Restitution.

The Victim And Witness Protection Act provides restitution to "victims." 18 U.S.C. 3663, as amended 18 U.S.C. 3663A. Federal agencies are victims for restitution purposes. U. S. v. Lincoln, 277 F.3d 1112 (9th Cir. 2002); U.S. v. Martin, 128 F.3d 1188 (7th Cir. 1997).

2. Energy Efficiency Rebates.

SEC, supra at *5 (Energy Policy Act of 1992 encouraged agencies to participate in energy efficiency programs, permitting them to keep a % of financial incentives/rebates).

3. Revolving Fund

Federal Emergency Management Agency—Disposition of Monetary Award Under False Claims Act, 63 Comp. Gen. 260 (Feb. 16, 1990) (but only ***if*** enabling legislation expressly authorizes agency to deposit money into the revolving fund).

4. Federal Medical Care Recovery Act, 10 U.S.C. § 1095.

Military Medical Treatment Facilities may retain recoveries from third party payers. Id. at §1095(g)(1).

5. Health Care Fraud And Abuse Control Account

Used to finance antifraud activities in health care; authorized by the Health Insurance Portability And Accountability Act of 1996 (HIPAA), P.L. 104-191.

6. DOJ 3% Debt Collection Fund

DOJ may credit up to 3% of its cash collections from its civil debt collection litigation activities to pay the costs of "processing and tracking" this litigation. Used for asset searches, as well as audits, statistical and analytical assistance. Authorized by section 108 of the DOJ Appropriations Act for FY 1994.

C. Money Received Qualifies As A "REFUND."

Refunds are defined as "returns of advances, collections for overpayments, adjustments for previous amounts disbursed, or recovery of erroneous disbursements from appropriations or fund accounts that are directly related to, and are reductions of, previously recorded payments from the accounts." Tennessee Valley Authority—False Claims Act Recoveries, B-281064 (Feb. 14, 2000).

1. Civil False Claims Act

   TVA, supra (Recovery of single (actual) damages and investigative costs directly related to the false claim permitted; by award or settlement)

   FEMA, supra (FCA settlement; FEMA may retain as a refund single damages, interest on the principle amount of false claims paid, and administrative expenses of investigation).

2. Replacement Contracts

   Bureau of Prisons—Dispositions of Funds Paid in Settlement of Breach of Contract Action, B-210160, 62 Comp. Gen. 678 (Sept. 28, 1983) (Excess reprocurement costs may be used by agency to fund a replacement contract).

   Army Corps of Engineers - - Disposition of Funds Collected in Settlement of Faulty Design Dispute, B-220210, 65 Comp. Gen. 838; 1986 U.S. Comp. Gen. LEXIS 584 (Sept. 8, 1986), at *5-6 (Excess reprocurement costs, obtained as a result of contractor default or defective workmanship, may fund a replacement contract).

   National Park Service—Disposition of Performance Bond Forefeited To Government by Defaulting Contractor, B-216688, 64 Comp. Gen. LEXIS 625, at * 6 (June 20, 1985) (Proceeds of performance bond forfeited by contractor may be used by agency to fund replacement contract).

3. Negotiated Contract Resolutions

   Securities and Exchange Commission – Reduction of Obligation of Appropriated Funds Due to a Sublease, B-265727 (July 19, 1996) (Contract adjustments or price renegotiations may be treated as refunds when the refund reflects "a change in the amount the government owed its contractor based on the contractor's performance or a change in the government's requirements.")

IV. LIMITATIONS

A. Penalties

Not considered refunds and must be deposited as miscellaneous receipts absent statutory authority to retain. TVA, supra.

B. Replacement Contracts

1. Refunds are credited to the appropriation or fund charged with the original expenditure and replacement contracts are funded only out of that appropriation. Department of Interior-Disposition of Liquidated Damages Collected for delayed Performance, B-242274, 1991 U.S. Comp. Gen. LEXIS 1072 (Aug. 17, 1991) at * 3.

2. There must exist a continuing bona fide need for goods or services covered by the original contract. Department of Interior, supra at *4.

3. The replacement contract must be the same size and scope as the original contract. Department of Interior, supra at *4; Bureau of Prisons, supra (Excess reprocurement costs may only be used to procure those goods and services that would have been provided under the original, breached contract).

C. "Closed" Appropriation Accounts [Grave Yard Dead]

Appropriation Accounting—Refunds And Collectibles, B-257905, 96-1 Comp. Gen. Proc. Dec. ¶130; 1995 U.S. Comp. Gen. LEXIS 821 (Dec. 26, 1995) at * 2 (If the appropriation account is closed, any recoveries go to the general fund of the Treasury).

D. Program Fraud Civil Remedies Act (PFCRA) Cases, 31 U.S.C. 3801-11

All recoveries returned to Treasury, except for USPO & HHS.

V. CONCLUSION

THE FRAMEWORK FOR CORPORATE SELF-GOVERNANCE:

AN EFFECTIVE ETHICS AND COMPLIANCE PROGRAM

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I. Introduction

Over the past decade, American corporations have become increasingly willing to accept responsibility for monitoring their own activities. This trend, in part, has been induced by the promotion and encouragement of corporate self-governance by government law enforcement authorities and regulators as well as by corporations' realization that their economic self-interest is served by preventing and detecting employee misconduct.[1]

Corporate self-governance is designed to ensure that a corporation aspires to and insists on uncompromising ethical behavior in its activities. Self-governance at its core involves the development of a "corporate ethic" or "corporate culture" of ethical conduct. A vigorous and effective ethics and compliance program provides two critical components of corporate self-governance: it causes a corporation to conduct its business in strict accordance with all applicable laws, rules, and regulations and it persuades corporate employees at all levels that operating within the bounds of the law is in the corporation's interest and, more importantly, in the interest of all of the corporation's employees.

This paper will discuss corporate ethics and compliance programs in three respects. First, it will identify the benefits and potential problems associated with developing and implementing a corporate ethics and compliance program. Second, it will outline the minimum elements necessary for an effective ethics and compliance program. Third, it will discuss the

[1] *See e.g.,* Pendergast & Gold, "Surviving Self-Governance: Common Interests Approach to Protecting Privileges under the DoD Voluntary Disclosure Program," 22 *Public Contract Law Journal* 195-97 (1993); Perry, Dakin & Gharakhanian, "State Attorneys General Encourage Voluntary Corporate Compliance Programs," *Corporate Conduct Quarterly*, Vol. 2, No. 4 (Spring 1993) at 49 - 54; Obermaier, "A Practical Partnership," *The National Law Journal*, November 11, 1991 at 1.

experience that Lockheed Martin Corporation has had with the development and implementation of its self-governance program.

II. Benefits And Potential Problems Associated With An Ethics and Compliance Program

A. Benefits of an Ethics and Compliance Program

The development and implementation of an effective ethics and compliance program offers a corporation a number of advantages.[2] As a fundamental matter, the true value of an ethics and compliance program lies in its ability to detect and prevent criminal and other improper activity by corporate employees. In other words, an effective ethics and compliance program will foster and encourage ethical conduct by employees in all aspects of the corporation's business. Constant reminders (and examples) to employees that it is the corporation's policy to abide by the law and to punish violators discourage and deter criminal behavior and other unethical conduct, discourage employee tolerance of improper activity, and encourage employees to report misconduct to management. The early detection of misconduct maximizes a corporation's ability proactively to respond to and address the causes of wrongdoing and to minimize its consequences.[3]

The financial savings resulting from the prevention or early detection of criminal and other improper conduct are substantial. A corporation can avoid criminal, civil, and

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[2] *See generally*, "Seven Steps May Help Corporations Avoid Criminal Liability," *BNA Corporate Counsel Weekly*, Oct. 21, 1998, at 7-8; Webb & Molo, "Some Practical Considerations in Developing Effective Compliance Programs: A Framework for Meeting the Requirements of the Organizational Sentencing Guidelines," 71 *Washington University Law Quarterly* 375 (1993); Sandler & Klubes, "The Organizational Sentencing Guidelines: Increased Criminal Penalties for Corporations and the Implications for Corporate Self-Governance," *The Lawyers Brief* (Feb. 29, 1992).

[3] *See* "Programs for Employees Keep Companies on Track Ethically," *BNA Corporate Counsel Weekly*, Dec. 9, 1998 at 5 (reporting view that business professionals behave unethically due to pressure to achieve management

administrative fines, penalties, offsets, civil judgments in *qui tam* and shareholder lawsuits, and the significant legal fees associated with litigation with either the government or private parties. Moreover, an effective ethics and compliance program may prevent the loss of business which will result from suspension or debarment from government contracting, denial of export licenses, the loss of customer confidence, or a damaged reputation. In addition, prevention or early detection of misconduct will avoid the employee morale and productivity disruptions that often accompany an investigation of, or legal action involving, allegations of corporate impropriety.

One of the more significant advantages of a corporate ethics and compliance program is avoiding altogether prosecution for the criminal acts of corporate employees. This point was underscored by a former senior prosecutor from the United States Department of Justice in remarks made September 8, 1995, to a United States Sentencing Commission symposium on corporate compliance and ethical behavior. Then Deputy Assistant Attorney General Robert S. Litt of the department's criminal division pledged that strong compliance efforts will receive serious consideration by federal prosecutors deciding whether to charge corporations.[4] Mr. Litt acknowledged that prosecutors realize that no compliance program is going to prevent all criminal activity by rogue employees. What is important, Mr. Litt pointed out, is that a corporation be able to demonstrate that the measures that it has taken are "effective" even though a crime occurred. Mr. Litt noted that prosecutors have long taken into account the existence of a compliance program in deciding whether to bring charges against a corporation.

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objectives, with top pressures including: (1) meeting overly aggressive financial priorities; (2) meeting schedule priorities; (3) helping the organization to survive; and (4) rationalizing other peoples' often unethical behavior).

[4] 57 Crim.L.Rptr. 1580 (September 20, 1995).

"A good corporate citizen, one that is devoted to an effective compliance program, is much less likely to be prosecuted itself for the acts of its wayward employees," Mr. Litt stated.[5]

In another forum, Department of Justice Fraud Section Deputy Chief Barbara A. Corprew emphasized the benefits that may attach to a corporation committed to self-governance:

> If a company is a corporate good citizen, we may not prosecute . . . the Justice Department looks for programs that establish a culture of integrity throughout the organizations. Companies should be aware that, during an enforcement action, the Department will examine whether the program is a facade or indeed a genuine ethics program . . . the Justice Department has been observing a change in attitude in the corporate community. More companies are taking responsibility for compliance efforts, more in-house training programs are available and more problems are being reported through company hotlines . . . the public is best served when companies seek out and solve their own problems . . . [6]

Two prominent cases highlight the comments of Mr. Litt and Ms. Corprew concerning the Department of Justice's willingness to factor a corporation's ethics and compliance efforts into the exercise of prosecutorial discretion. In May 1992, the United States Attorney's Office for the Southern District of New York elected not to prosecute Salomon Brothers in connection with a managing director's misconduct in auctions of United States Treasury securities largely due to Salomon's disclosure of the misconduct, its cooperation with law enforcement authorities, and its agreement to institute remedial measures designed to prevent reoccurrence

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[5] *Id.*

[6] *Federal Ethics Report*, Vol. 3, Issue 7 (July 1996) at 4. More recently, at the 13th annual Defense Industry Initiative on Business Ethics and Conduct Forum in June 1999, Philip Urofsky, a trial attorney for the U.S. Department of Justice Fraud Section, discussed how the department decides to prosecute a company when one or more of its employees has violated the Foreign Corrupt Practices Act ("FCPA"). Mr. Urofsky stated that prosecutors from different divisions of the department give different weight to the existence of a compliance program when deciding whether to prosecute. For FCPA violations, the Fraud Section weighs the existence of a compliance program in deciding to prosecute. If a company has a good compliance program and the violations are committed by a rogue employee, the company may avoid prosecution. Mr. Urofsky added, however, that the

of the violations. On the other hand, in May 1999, the same office prosecuted Bankers Trust Company for a scheme in which senior officers and employees illegally diverted $19.1 million in unclaimed checks and other credits owed to customers into the bank's own books to enhance its financial performance. The United States Attorney credited Bankers Trust officials with first uncovering the scheme and reporting it to the government, but accused the bank of initially minimizing the extent of the culpability of its officers and employees and noted that the scheme originated after senior management placed severe pressure on managers to generate revenues to meet financial targets.[7]

An effective ethics and compliance program, however, does not mean that a corporation will never be prosecuted. In a recent policy paper issued by the Department of Justice on June 16, 1999, entitled "Federal Prosecution of Corporations," [8] the Department outlines the factors federal prosecutors should consider in deciding whether to pursue criminal charges against corporations. The guidance recognizes that the existence of a corporate compliance program may play a significant role in a prosecutor's charging decision.[9] "The

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further up the chain of command the violation goes, the more likely a corporate prosecution becomes. *Federal Ethics Report*, Vol. 6, Issue 7 (July 1999) at 5.

[7] *See* Benjamin Weiser, "Bankers Trust Says It Illegally Diverted Unclaimed Money," *The New York Times*, Mar. 12, 1999, at A1; Obermaier, "Do the Right Thing -- But if a Company Doesn't, It Can Limit the Damage," *Barron's*, Dec. 14, 1992, at 18 (comparing the Salomon Brothers case and a securities fraud case in which the United States Attorney for the Southern District of New York prosecuted the Cooper Companies after the company resisted any acknowledgement of wrongdoing). In September 1996, the United States Attorney's Office for the Central District of California elected not to prosecute Coopers & Lybrand in connection with its dealings with then-indicted (later convicted and then granted a new trial on appeal) former Arizona Governor J. Fyfe Symington. The United States Attorney's Office's decision, in part, was based on Coopers' agreement to cooperate with the government, its recognition of the impropriety of its employees' conduct, and its agreement to establish a company-wide ethics program for all employees. *See* "Coopers Settles in Symington Dealings," *The Wall Street Journal*, September 23, 1996, at B12.

[8] "Federal Prosecution of Corporations," U.S. Department of Justice (June 16, 1999), *reprinted in,* 66 Crim.L.Rptr. 189 (Dec. 8, 1999).

[9] *Id*. at 190.

Department of Justice encourages such self-policing," the guidance states, but "the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct . . ."[10]

Even if an effective ethics and compliance program does not prevent prosecution, it can minimize the severity of a corporation's sentence upon conviction. The Organizational Sentencing Guidelines reduce a corporation's "culpability score" by three points if an offense occurred "despite an effective program to prevent and detect violations of the law."[11] This reduction can result in substantial mitigation of the sentencing fine range and the corporation's sentencing exposure (in some instances up to eighty percent).[12] In addition, an effective ethics and compliance program may prevent imposition of a burdensome and intrusive sentence to a term of organizational probation.[13]

Aside from having a role in avoiding or mitigating criminal prosecution, an effective ethics and compliance program will reduce the potential for suspension or debarment from

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[10] *Id*. at 192. According to the Department of Justice guidance, "the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. *Id*. In evaluating whether a company's program is well designed and whether it works, the guidance explains, a prosecutor should look at its comprehensiveness, the extent and pervasiveness of the wrongdoing, how many employees were involved and how high up in the company they were, the seriousness, duration, and frequency of the lawbreaking, and remedial measures -- restitution, discipline, program revisions -- undertaken by the corporation, and the promptness of any voluntary disclosure and the extent of any cooperation. *Id*.

[11] U.S.S.G. § 8C2.5(f). The three-point reduction is lost if a "high level individual" or an "individual responsible for administration or enforcement" of the compliance program participated in, condoned, or was willfully ignorant of the offense." *Id*.

[12] *See* U.S.S.G. §§ 8C2.6 and 8C2.7.

[13] *See* U.S.S.G. § 8D1.1(a)(3). In 1996, 96 companies were placed on probation, nearly twice as many as in 1993. "Corporate Monitors Form a New Industry," *The Wall Street Journal* (December 1, 1997) at B12. In some instances, companies have found particularly onerous and disruptive, the conduct of outside monitors appointed by the sentencing court as a condition of probation in order to provide the court with continuing authority over the day to day operations of the corporation.

government contracting, a serious administrative action that poses a substantial threat to the economic viability of a corporation. The Federal Acquisition Regulations ("FAR") provide, and experience shows, that suspension and debarment authorities will favorably consider an ethics and compliance program in assessing the present responsibility of a corporation.[14]

Finally, the creation and implementation of an effective ethics and compliance program may shield company directors from personal liability arising from the wrongdoing of employees. The Delaware Court of Chancery in *In re Caremark International Inc. Derivative Litigation*, in the context of approving a settlement of a derivative action, held that Caremark's directors did not breach their duties to shareholders because they took steps to ensure that the corporation had a compliance system (an "information and reporting system") to assure the board that appropriate information would come to its attention in a timely manner as a matter of ordinary operations.[15] Some of these steps including naming the chief financial officer as the corporate compliance officer, creation of an internal audit plan monitored by a board committee designed to assure compliance with business and ethics policies, and the compilation of an employee ethics handbook concerning compliance policies (including the requirement for all employees to report illegal conduct to a toll-free confidential ethics hotline). The court made two interesting observations. First, it noted that any corporate self-governance effort must take into account the requirements of the organizational sentencing guidelines.[16] Second, it pointed out that no rationally designed information and reporting system will remove the

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[14] *See* FAR subparts 9.406-1(a)(1) and 9.407-1(b)(2); 48 C.F.R. §§ 9.406-1(a)(1) and 9.407-1(b)(2).

[15] *In Re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del.Ch. 1996). The derivative action before the court arose from a 1994 federal indictment of Caremark, which led in 1995 to Caremark pleading guilty to a single felony charge and its payment of $250 million in criminal fines, civil penalties, and civil damages.

[16] *Caremark* at 970.

possibility that the corporation will violate laws or regulations, or that senior officers or directors may nevertheless sometimes be misled or otherwise fail reasonably to detect acts material to the corporation's compliance with the law.[17]

B. Potential Problems Associated with an Ethics and Compliance Program

Although outweighed by the benefits, there are potential problems associated with the implementation of an ethics and compliance program.[18] Once a corporation establishes compliance standards, it must devote the necessary resources to ensure that the standards are met or risk having the compliance program deemed "non-effective" due to lack of enforcement. In some instances, a corporate ethics and compliance program may be used as a sword against the corporation. For example, a prosecutor or plaintiff's counsel may try to use a corporation's ethics and compliance program as the standard by which employee conduct should be judged in a civil or criminal trial, arguing that any failure to meet the program's requirements is indicative of fraudulent intent, a knowing act, or negligence.[19]

An ethics and compliance program may generate through reporting procedures and an internal investigation damaging evidence that, if obtained by government investigators or private litigants, will assist in the development of a criminal or civil case against the corporation and could ultimately lead to the corporation's prosecution. Reporting procedures or an internal investigation may also alert corporate employees to suspected wrongdoing and

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[17] *Id*.

[18] Webb & Molo, "Some Practical Considerations in Developing Effective Compliance Programs: A Framework for Meeting the Requirements of the Organizational Sentencing Guidelines," 71 *Washington University Law Quarterly* 379 (1993).

[19] *Id., citing,* Pitt & Groskaufmanis, "Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct," 78 *Geo.L.J.* 1559, 1605-14 (1990).

these employees may take advantage of such information and file lawsuits against the corporation under the *qui tam* provisions of the Civil False Claims Act. In that regard, taking disciplinary action against employees may not only cause them to become *qui tam* relators, but can serve as a "roadmap" for government investigators by providing insight into the corporation's assessment of relative culpability among sanctioned employees through a comparison of the varying severity of discipline imposed.

Although the results of an internal investigation are normally protected by the attorney-client privilege, prosecutors and private litigants in some instances nonetheless may obtain access to the information. A corporation may elect to disclose to the government portions of an internal investigation's findings in an effort to avoid indictment, mitigate sentencing exposure or avoid suspension or debarment. Such disclosure, however limited, creates a substantial risk that the corporation will waive the attorney-client or work product privileges, not only with respect to the internal investigation's findings, but to all information related to the same subject matter.[20]

III. Elements Of An Effective Ethics and Compliance Program

Aside from the substantial volume of literature addressing ethics and compliance programs generated by the private bar and commentators,[21] corporations can look to three sources from which to derive the essential elements of an effective ethics and compliance

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[20] *See e.g.*, *United States v. Massachusetts Institute of Technology*, 129 F.3d 681 (1st Cir. 1997); *In re Steinhardt Partners*, 9 F.3d 230 (2d Cir. 1993); *Westinghouse Electric Corporation v. Republic of Philippines*, 951 F.2d 1414, 1428-29 (3d Cir. 1991); *In re Martin Marietta Corporation*, 856 F.2d 619 (4th Cir. 1988), *cert. denied*, 490 U.S. 1011 (1989); *United States ex rel. Mayman v. Martin Marietta Corporation*, 886 F. Supp. 1243 (D.Md. 1995); *In re Leslie Fay Companies, Inc. Securities Litigation*, 152 F.R.D. 42 (S.D.N.Y. 1993).

program. The primary source is, of course, the Organizational Sentencing Guidelines at Chapter 8 of the United States Sentencing Guidelines. Two other sources exist, however, particularly for corporations doing business with the Department of Defense ("DoD"). The Defense Federal Acquisition Regulations Supplement ("DFARS") establishes for DoD contractors the general requirement for ethical conduct, defines broad program elements, and provides examples of what a system of management controls should include.[22] The Defense Industry Initiative on Business Ethics and Conduct ("DII") principles provide another source for ethics and compliance program elements.

A. Organizational Sentencing Guidelines

The Organizational Sentencing Guidelines specify the type of corporate compliance effort that is required for mitigation of a corporation's sentence upon conviction.[23] As a practical matter, however, the real benefit to corporations of instituting an effective ethics and compliance program will not be at sentencing, but will be in its role in preventing crime in the first place.

The Guidelines provide that an "effective program to prevent and detect violations of law" means a program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct.[24] The hallmark of an effective program to prevent and detect violations of law, according to the Guidelines, is that

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[21] *E.g.,* James A. Dobkin, "Fundamental Principles for Organizational Compliance Programs: A Practitioner's Perspective," *Federal Contracts Report*, Vol. 68, October 13, 1997, at 416; Rakoff, Blumkin & Sauber, *Corporate Sentencing Guidelines: Compliance and Mitigation*, Law Journal Seminars-Press (1993).

[22] DFARS Subpart 203.70, 48 C.F.R. § 203.70.

[23] U.S.S.G. § 8A1.2. (n.3(k)).

[24] *Id*.

the organization exercised **due diligence** in seeking to prevent and detect criminal conduct by its employees and other agents.[25]

The Guidelines articulate the minimum steps that the organization must take to establish that it exercised due diligence:[26]

(1) The organization must establish compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.

(2) High-level individuals within the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.

(3) The organization must use due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities.

(4) The organization must take steps to communicate effectively its standards and procedures to all employees and other agents, *e.g.,* by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required.

(5) The organization must have taken reasonable steps to achieve compliance with its standards, *e.g.,* by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution.

(6) The standards must be consistently enforced through appropriate disciplinary measures, including, as appropriate, discipline of individuals responsible for failure to detect an offense. Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however the form of discipline that will be appropriate will be case specific.

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[25] *Id*.

[26] U.S.S.G. § 8A1.2. (n.3(k)(1)-(7)).

(7) After an offense has been detected, the organization must take all reasonable steps to respond appropriately to the offense and to prevent further similar offenses -- including any necessary modifications to its program to prevent and detect violations of law.

The Guidelines explain that the precise actions necessary for an effective program to prevent and detect violations of law will depend upon a number of factors:[27]

(1) Size of the organization -- The formality of a compliance program will vary with the size of the organization. Larger organizations must have more formal programs with established written policies defining the standards and procedures to be followed by its employees and other agents.

(2) Likelihood that certain offenses may occur because of the nature of its business -- If the nature of an organization's business engenders a substantial risk that certain types of offenses may occur, the program must focus on those offenses.

(3) Prior history of the organization -- An organization's prior history may indicate types of offenses that it should take actions to prevent.

(4) An organization must incorporate and follow applicable industry practice or the standards called for by any applicable governmental regulation.

The Guidelines reward self-reporting and cooperation by sentence mitigation.[28] The Guidelines urge an organization to take responsibility for its actions as soon as it detects an offense. The organization must disclose wrongdoing to government authorities and its cooperation must be both timely and thorough. The Guidelines require that the organization must begin cooperating at the time it receives notice of an investigation and the organization

[27] U.S.S.G. § 8A1.2. (n.3(k)).

[28] U.S.S.G. § 8C2.5(g).

must disclose all pertinent information sufficient for law enforcement officials to identify the nature and extent of the offenses and the responsible individuals.

B. DFARS Subpart 203.70

DFARS Subpart 203.70 articulates policy and procedures applicable to government contractor ethics programs that are directly relevant to establishing and implementing a compliance program and, in general terms, complement the compliance requirements established by the Organizational Sentencing Guidelines. The DFARS policy statement is straightforward: government contractors must conduct themselves with the highest degree of integrity and honesty.[29] To meet this goal, the DFARS requires that contractors have standards and internal control systems that:

(1) Are suitable to the size of the company and the extent of their involvement in government contracting.

(2) Promote such standards.

(3) Facilitate the timely discovery and disclosure of improper conduct in connection with government contracts.

(4) Ensure corrective measures are promptly instituted and carried out.[30]

The DFARS identifies elements that a contractor's system of management controls should provide for:

(1) A written code of business ethics and conduct and an ethics training program for all employees.

[29] DFARS Subpart 203.7000; 48 C.F.R. § 203.7000.

[30] *Id*.

(2) Periodic reviews of company business practices, procedures, policies, and internal controls for compliance with standards of conduct and the special requirements of government contracting.

(3) A mechanism, such as a hotline, by which employees may report suspected instances of improper conduct, and instructions that encourage employees to make such reports.

(4) Internal and/or external audits as appropriate.

(5) Disciplinary action for improper conduct.

(6) Timely reporting to appropriate government officials of any suspected or possible violation of law in connection with government contracts or any other irregularities in connection with such contracts.

(7) Full cooperation with any government agencies responsible for either investigation or corrective actions.[31]

C. DII Principles

In 1986, representatives of eighteen defense contractors drafted six key principles of business ethics and conduct. The principles, which became known as the DII principles, pledge the signatory companies to implement policies, procedures, and programs in six areas.

(1) Company codes of ethics.

(2) Ethics training for employees.

(3) Internal reporting of alleged misconduct.

(4) Self-governance through the implementation of systems to monitor compliance with federal procurement laws and the adoption of procedures for voluntary disclosure of violations to the appropriate authorities.

(5) Responsibility to the industry through attendance at Best Practices Forums.

(6) Accountability to the public.

[31] DFARS Subpart 203.7001; 48 C.F.R. § 203.7001.

The DII principles generally reflect the policies and procedures of corporate self-governance and effective ethics and compliance programs articulated by the Organizational Sentencing Guidelines and the DFARS.

IV. Lockheed Martin's Self-Governance Program

Lockheed Martin Corporation was formed on March 15, 1995, through the merger of Lockheed Corporation and Martin Marietta Corporation. While each company brought with it a commitment to ethical conduct and compliance programs, the merger afforded Lockheed Martin Corporation a unique opportunity to emphasize core ethical principles central to the new corporation and a self-governance program designed to ensure that those core ethical principles became an integral part of doing business throughout the corporation.

Fundamental to Lockheed Martin's self-governance program is the establishment and promulgation of a strong corporate culture of ethical conduct. In a videotape shown to all new employees, the President and Chief Operating Officer of Lockheed Martin makes it clear that the Corporation is committed to the highest standards of ethical conduct in every aspect of its dealings with all its constituencies: employees, customers, communities, suppliers, and shareholders. The videotape highlights the Corporation's guiding ethical principles:

(1) Honesty: to be truthful in all our endeavors; to be honest and forthright with one another and our constituencies.

(2) Integrity: to say what we mean, to deliver what we promise, and to stand for what is right.

(3) Respect: to treat one another with dignity and fairness, appreciating the diversity of our workforce and the uniqueness of each employee.

(4) Trust: to build confidence through teamwork and open, candid communication.

(5) Responsibility: to speak up -- without fear of retribution - and report concerns in the workplace, including violations of laws, regulations and company policies, and seek clarification and guidance whenever there is doubt.

(6) Citizenship: to obey all the laws of the United States and the foreign countries in which Lockheed Martin does business and to do our part to make the communities in which we live a better place to be.

A key element of Lockheed Martin's ethics and compliance program is high-level program management. To develop and implement its self-governance program, the Corporation established the Office of Ethics and Business Conduct and the position of Vice President of Ethics and Business Conduct. The Vice President of Ethics and Business Conduct reports directly to the Office of the Chairman and to the Audit and Ethics Committee of the Board of Directors. The Vice President of Ethics and Business Conduct annually attends two meetings of and has unrestricted access to the Audit and Ethics Committee of the Board of Directors and reports on matters of ethics, compliance, and business conduct.

The Corporation has also created the Corporate Ethics and Business Conduct Steering Committee. The Committee is chaired by the Corporation's President and Chief Operating Officer, and is further comprised of senior corporate officers including the Vice President of Ethics and Business Conduct, the Vice President and Chief Financial Officer, Senior Vice President and General Counsel, Vice President of Human Resources, Vice President of Internal Audit, Vice President of Business Development and, on a rotating basis, one Business Area Executive Vice President and four Business Unit Presidents representing the other business areas of the Corporation. The Committee meets quarterly to provide guidance, counsel, and strategic direction on the Corporation's ethics and business conduct programs to

include monitoring compliance with applicable laws, regulations, and business practices policies, oversight of corporate-wide ethics education and awareness programs, reviewing ethics and compliance program performance of business units (including foreign locations), and reviewing ethics helpline statistics, trends, and survey data.

Each business unit within Lockheed Martin has established a steering committee with similar responsibility for management and oversight of its ethics and business conduct program. A business unit committee is chaired by the business unit president and includes, at a minimum, the senior human resources, legal, internal audit, and finance executives, and the business unit ethics officer.

The Corporation has developed and distributed to each of its more than 128,000 employees a code of conduct designed to ensure that every employee understands and adheres to the Corporation's principles of integrity and ethical behavior as well as its policies and procedures. Lockheed Martin's Code of Ethics and Business Conduct, entitled "Setting the Standard," updated in 1999 to reflect Lockheed Martin's global business environment, provides a common source of reference for general ethical guidance for all employees at every level of the corporation. The code initially was distributed to each employee individually by his or her immediate supervisor during annual live ethics training and is provided to all new employees. All employees must acknowledge receipt of the code in writing or via electronic acknowledgment. The code, published in English and 13 other languages, is a pocket-sized, spiral-bound booklet, which articulates the Corporation's core ethics principles of honesty, integrity, respect, trust, citizenship, and responsibility, as well as general standards of conduct and principles to guide employees in their daily activity. The code is also available for viewing by all employees, suppliers, or any other interested party at the Ethics Home Page at

the Corporation's website: www.lockheedmartin.com/about/ethics.html. Those general standards of conduct include:

(1) Treat in an ethical manner all those to whom Lockheed Martin has an obligation.

(2) Obey the law - Compliance with the law does not comprise our entire ethical responsibility, it is a minimum, absolutely essential condition for performance of our duties.

(3) Promote a positive work environment.

(4) Work safely.

(5) Keep accurate and complete records.

(6) Record costs properly.

(7) Strictly adhere to all antitrust laws.

(8) Know and follow the law when involved in international business.

(9) Follow the rules in using or working with former government personnel.

(10) Follow the law and use common sense in political contributions and activities.

(11) Carefully bid, negotiate, and perform contracts.

(12) Avoid illegal and questionable gifts or favors.

(13) Steer clear of conflicts of interest.

(14) Maintain the integrity of consultants, agents, and representatives.

(15) Protect proprietary information.

(16) Obtain and use company and customer assets wisely.

(17) Do not engage in speculative or insider trading.

To ensure complete and effective implementation of its ethics and compliance program, Lockheed Martin has created a corporate-wide ethics and business conduct organization. The

Office of Ethics and Business Conduct is responsible for the overall administration of the Corporation's ethics and business conduct program. The Vice President of Ethics and Business Conduct and business area executive vice presidents have appointed business area ethics directors while business unit ethics officers have been appointed by their respective business unit presidents in consultation with the Office of Ethics and Business Conduct. The business unit ethics officers report directly to their business unit presidents. Ethics officers are responsible for coordination and oversight of ethics programs and processes and serve as primary points of contact between the business unit and the Office of Ethics and Business to assure effective implementation of ethics awareness and reporting processes. The ethics officers advise and support business area executive vice presidents and business unit presidents in evaluating ethics issues and establishing and enforcing ethics policies and practices. In addition, ethics officers initiate investigations into allegations of misconduct and assure appropriate review and disposition, to include coordination necessary for discipline or corrective action.

Important components of the Corporation's self-governance program are its reporting and information hotlines, or "HelpLines." Ethics officers and confidential ethics helplines are available to all employees at both the operating business units and corporate level. Employees are urged via training, in the code of conduct, and by poster to use these resources without fear of retribution whenever they have a question or concern that cannot be readily addressed within their work group or through their supervisor. It is Lockheed Martin policy to foster a free and open atmosphere that allows and encourages employees to make inquiries, express work-related concerns regarding ethics issues, and to report business ethics violations or violations of law, regulations, policies, or procedures without fear of retribution or retaliation

for making such reports or inquiries. Posters placed on bulletin boards throughout the Corporation identify the appropriate ethics officer by name, provide a photograph, and include his or her telephone number, as well as toll-free Helpline numbers.

Ethics awareness and compliance training of each employee is an essential element of the Corporation's self-governance program. Training programs are centrally developed and locally administered and are designed to ensure that all employees are sensitive to ethical issues and standards. Moreover, the training programs are designed to ensure that all employees are aware of applicable laws, regulations, and standards of business conduct both in general and as they pertain to the employee's specific job function, as well as the consequences both to the employee and the company that may result from violations.

A key element of Lockheed Martin's ethics and business conduct program is a requirement that each employee receive live ethics awareness training from his or her supervisor on an annual basis. In 2000 and 2001, the training tool was *Ethic Daily,* a *USA Today*-style newspaper. *Ethics Daily* training focused on the application at work of the ethics principles of honesty, trust, respect, integrity, responsibility and citizenship. During the training, employee teams analyzed selected scenarios, styled as newspaper articles, and patterned on real workplace situations that occurred in the Corporation. Employees developed appropriate actions based on an article's facts, identified the applicable ethical principles that these actions entailed, and created headlines to describe the article. Managers and supervisors, who personally conduct the training for their employees, facilitate ethics awareness training sessions. The training begins with the Lockheed Martin Chairman and Chief Executive Office conducting training with his senior staff. Ethics awareness training then cascades from the top down to the business areas and business units throughout the Corporation.

The Corporation believes that for its ethics program to be effective, supervisors and managers must link their dialogues on performance to reminders about the Corporation's values emphasizing mission success, teamwork, and a commitment to the highest standards of ethical business conduct. All employees at Lockheed Martin are part of the ethics program, and supervisors and managers are responsible for leading the annual ethics awareness training sessions.

Compliance training related to business conduct is the complement of ethics awareness training in the Corporation's self-governance program. Compliance training is developed and implemented locally based on broad guidance from corporate elements. Designated corporate staff ("responsible executives") are charged with ascertaining training needs in their areas of responsibility, ensuring that compliance areas are identified, and that appropriate training materials and curricula are developed and implemented. The corporate responsible executives name corporate subject matter experts to support the compliance effort.

Every three years, corporate elements as well as business areas and business units, develop or update a compliance training plan tailored to their respective organizations, consistent with guidance from the Office of Ethics and Business Conduct. Each business unit names its own responsible officials and subject-matter experts for each area identified for training. To ensure that each employee is knowledgeable about applicable laws, regulations, and standards of business conduct pertinent to his or her particular job function, the plans include a training matrix detailing the training to be provided, how it will be conducted, who will receive the training, and how it will be tracked and reported.

Compliance training is provided locally at business units through a number of delivery options, including: interactive multimedia CD ROM's, web-based training modules,

desktop/laptop compatible training modules, linear videos, all-hands meetings, staff meeting discussions, classroom training, training bulletins, and pamphlets. Business units have the flexibility to determine which combination of delivery options offers the most effective and efficient manner in which to conduct compliance training. Training modules on CD-ROM and available for web-based delivery include, among others, Antitrust Compliance; Drug-Free Workplace; Environment, Safety and Health; Export Control; Foreign Corrupt Practices Act; International Military Sales; Sexual Harassment; Truth-in-Negotiations Act; Procurement; Material Costs; Kickbacks and Gratuities; Product Substitution; Organizational Conflict of Interest; Software License Compliance; Government Property; Insider Trading, and Procurement Integrity.

In an effort to increase the efficiency and lower the costs of compliance training, the Corporation has implemented a Web-based tool called Qwizard. Qwizard allows employees to take compliance training quizzes, the same quizzes taken at the end of a CD-ROM training module, on-line at their desks. Qwizard enables employees who know the material in the CD-ROM modules to reduce significantly the amount of time they spend on recertification compliance training without compromising the Corporation's ability to say with absolute certainty that employees demonstrate the compliance knowledge and competency they need.

The Corporation believes that continuous reinforcement of the commitment to ethical business conduct is an essential component of its self-governance efforts. To that end, there are frequent ethics columns in *Lockheed Martin TODAY*, the corporate-wide newspaper. Each *TODAY* ethics column focuses on current activities of the Office of Ethics and Business Conduct or addresses issues of general interest. A periodic guest ethics column by corporate executives is published as tangible evidence of senior management's involvement in and

support of the ethics process at the Corporation. Moreover, current ethics and compliance related materials and items of interest, together with links to other ethics sites, are available to employees not only on the Corporate Business and Ethics Conduct Office's website, but on a variety of websites maintained or supported by Lockheed Martin company ethics offices across the Corporation.

Two final elements are essential to Lockheed Martin's self-governance program. First, internal audit each year creates an audit plan for and audits the Corporation's operations for compliance with its ethics and compliance program. This audit effort is in addition to internal audit's more traditional compliance-related focus on management control systems and contract compliance. Included in this audit coverage is a review of the Corporation's progress in completing compliance training requirements. Second, as part of its self-governance program, Lockheed Martin has adopted a policy of voluntarily disclosing to responsible authorities (in most cases the DoD Office of the Inspector General and the Department of Justice) violations of law or significant employee misconduct. Lockheed Martin has found that employee awareness and appreciation of the Corporation's policy to disclose improper behavior to the government is an extremely effective method of communicating to employees the unequivocal nature of the Corporation's commitment to ethical behavior and is a powerful deterrent against improper behavior.[32]

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[32] The Organizational Sentencing Guidelines reward self-reporting and cooperation, U.S.S.G. § 8C2.5(g), and require, as part of an effective program to prevent and detect violations of law, that a corporation adequately discipline an employee responsible for a violation of the law. U.S.S.G. §8A1.2. (n.3(k)(6)). Companies confronted with employee misconduct are becoming increasingly willing to disclose that misconduct to government law enforcement agencies and to cooperate with the government's investigation of the employee. *See* "Pollution Case Highlights Trend To Let Employees Take the Rap," *The Wall Street Journal* (October 9, 1997) at B8. In response to *The Wall Street Journal*'s article, one commentator has advised that turning against an employee may not always be the optimal course of action for a company, as the company may need the cooperation of such employees for its defense and casting individual employees aside may hasten their turning

V. Conclusion

Like many corporations, Lockheed Martin Corporation has taken responsibility for self-governance because it is the right thing to do and because ethics and compliance programs are a good business practice. Lockheed Martin's self-governance program goes beyond a mere focus on rules that is associated with many compliance programs, to a broader focus on ethical values and conduct as a way of business. In doing so, Lockheed Martin seeks to prevent employee misconduct before it happens and thereby successfully measure up to the intense scrutiny and high standards to which the government, shareholders, industry, and the public hold Lockheed Martin in all its operations.

Lockheed Martin's efforts in that regard were formally recognized on September 8, 1998, when the American Society of Chartered Life Underwriters & Chartered Financial Consultants announced that it had awarded to Lockheed Martin Corporation its 1998 American Business Ethics Award ("ABEA") in the public company category. Awarded annually since 1994, the ABEA recognizes companies from three categories -- public company, private company, and small business -- that demonstrate a firm commitment to ethical business practices in everyday operations, management philosophies, and response to crisis or challenges.

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against the company. Richard M. Cooper, "Is It Always Smart for a Company to Let Employees Take the Rap?" *Business Crimes Bulletin*, Vol. 4, No. 9 (October 1997) at 1.

Information for this area not available.